

DOES GROWTH FURTHER IMPROVE ECONOMIC FREEDOM?

By

Miroslav Prokopijevic

March 2002

**“...the reformer has enemies in all these who profit
by the old order, and only lukewarm defenders in
all those who would profit by the new”.**

Machiavelli, **The Prince**, Ch. VI.

Abstract: Countries without natural resources or foreign aid can grow just if they do serious economic liberalization. Liberal reforms are first followed by a post-reform recession, and afterwards with growth, provided they create a well business environment, compared to alternatives. Economies growing because of liberalization just exceptionally undertake further reforms in order to enlarge gains – is the main finding of this study. On the one side, reforms are costly, and after having paid once, people prefer to extract gains, instead to invest again. On the other side, reforms create seeds of their own destruction, by crating environment for a new wave of rent seeking. Other reasons for why countries do not liberalize again, after doing one move, are country-groups specific. After a brief introduction (I), the data indicating degree of liberalization and growth rates throughout the world in the period 1970-2002 are presented (II). The scope of analysis is restricted to some four groups of countries (developed, recently developed from the Far East, transition and Latin American countries), and it is found that - beyond general reason – reform processes merely depend on just a few factors, like previous development, democracy, the rule of law, the conditions in tradable and non-tradable sectors, and the ruling team.(III) Final chapter is about concluding remarks (IV).

I) INTRODUCTION

The pioneers of economics were aware that transactions do not occur in a social vacuum, and they acknowledged the influence of institutions on economy by providing the analysis of them, and by baptizing the newborn 'political economy'.¹ Classical economic approach in its mainstream faded away institutional dimension, and suggested that even if policy in a country is unable to create favorable conditions for doing business, a general movement of capital - driven by increasing/diminishing marginal productivity - will provide also such countries with growth, since the capital will flow to other destinations once it has exploited advantages in some country. It follows that it is not important what actors of economic life do, since growth seems to be a nearly automatic process. It also follows that the whole world one day will end in a prosperous, developed but growth-free nirvana. Capital accumulation reduces the marginal product of capital, eventually making investment unprofitable and halting capital accumulation and growth.

The neoclassical framework found exit out of nirvana trap, by allowing other factors to offset the fall of marginal productivity of capital, but fell victim of following blindly otherwise useful idealization, about the maximizing behavior of economic man. Economic actor has stable preferences, he is perfectly informed about the alternatives, and the maximizing behavior governs him. Property rights are well defined, transactions costs are low if not zero, markets are perfectly liquid, corruption, theft and rent-seeking are unknown. By finding the exit outside nirvana trap, neoclassical economic theory from 1950s has produced a controversy, on whether growth is driven by endogenous or exogenous forces, by manipulating changes in a tentative institutional design of some countries as a growth factor. Endogenous growth models deny such automatic increasing /decreasing aggregate returns, and so the differences in growth rates across countries can persist forever. Exogenous growth model, like that of Solow, enjoyed a lot of popularity, and has gone along neoclassical lines, predicting that growth creates the seeds of its own destruction. By saying that growth may be endogenous, neoclassical approach gave hint in changing the classical heritage.

¹ By working on this study I have enjoyed the generous hospitality of the ICER. Earhart foundation and Atlas Economic Research Foundation from the USA also supported the work on this study. I would like to thank Steiner Strøm, Oslo University, and Enrico Colombatto, ICER & Turin University for very helpful comments on this paper. Usual caveat applies.

Insufficiencies in explaining growth were just one among many reasons² for decline of the classics and neo-classics. Fresh beginning has connected XVIII century economics with new findings. At least from Adam Smith on there is a line of reasoning, that economic freedom – understood in Hayek’s sense as ‘absence of coercion’ - promotes growth³ and affluence. Current studies even suggest a close statistical correlation between economic freedom and growth rates. (Henke & Walters, 1997) Statistical correlation, naturally, does not imply a causal connection. However, if this line of reasoning is conclusive, there are some implications and questions. First, if economic freedom so decisively supports growth and eventually creates the state of affluence, does an absence of economic freedom lead to backwardness, shortage and poverty, which again induce revolt and revolution? Secondly, if the degree of economic freedom is decisive for economic growth and prosperity, as suggested by empirical findings and principal reasoning, and if the economic growth is so widely desirable, as many believe it is, one would expect to see a strong demand for economic freedom in a majority if not in nearly all countries. Even more, to countries there is an open way of perpetual growth, based on entrepreneurial innovations creating the consumers’ surplus, as Schumpeter envisaged at the beginning of XX century. That no country found this way of prosperity, although strongly supported by Pareto improvement and other theoretical considerations, suggests that there are some obstacles along the way. Thirdly, if economic freedom is so decisive for prosperity, why are the results in so many cases counterfactual? For example, why Singapore is at the top of the list ranking countries according the degree of economic freedom, even if its development was a result of visible no less than an invisible hand? Or, why Czech Republic with a higher degree of economic freedom has an inferior macroeconomic performance than Slovenia, which enjoys a significantly lower level of economic freedom? In this study I will concentrate on the second question, while the other two questions will be addressed at the margin.

Before entering into this debate, let us say what this paper cannot cover. Investigations focused on the institutional environment of an economy are not able to take into account some eventual other

² “/Neoclassical economics/ has immensely enriched our understanding of the economic forces at work. However, the basic assumptions of the neoclassical economics hamper its ability to explain a wide range of real world events. Those assumption are maximizing behavior, stable preferences, and market equilibrium. The first assumption ignores the transaction costs of identifying and pursuing maximizing behavior; the second assumption ignores that preferences do not exist independently for the knowledge-creating process of exchange through which they are generated; and the third assumption directs analysis away from the process of adaptation and toward the search for unique solutions in a world of many different property rights, positive transaction costs, and incomplete knowledge.” Pejovic 1999.

³ Growth can be attributed to increase in labor force, to total productivity of to both.

factors. Corporations and other firms undergo cycles. As a rule, young firms earn significantly higher returns relative to their costs of capital than the old ones.

Other authors argue, relying on shift from future to present consumption, that the growth and prosperity induced by long economic upswings changes individual rates of time preference thereby resulting in a fall in the saving rate, decline in investment and an economic contraction. And some others argue that instead of a shift in time preference, there is a shift from work to leisure, from hard work to pleasant and quiet work, and from risk taking to risk aversion. Aging populations in a number of countries is also outside the scope of this paper.

Perpetual growth is not the case in any country, and the number of them shows a negligent interest in improving economic freedom. I will put aside these countries here,⁴ and concentrate just on those that made advances in economic freedom in the last decades. One may expect that countries successful in improving the economic freedom in one period of time, would like to go further in improving it in the future as well, in order to make better business environment for their individuals and firms, and so ‘making’ their countries even more successful. This development, however, is to be observed just in rare cases rather than as a rule.

Why countries that grow faster do not tend to become freer in economic sense? Why they do not liberalize permanently until they reach an extremely high level of economic freedom? Let us first see the evidence.

II) GETTING THE PICTURE: DATA

In order to find out economies, which grow due to liberalization, some preparatory work is inevitable. *Appendix 3* offers a survey of growth rates for different countries during 1970-1999.⁵ Putting aside a general reliability of macroeconomic data, what is an issue in economics for longer time, there are also some other problems to be mentioned. A number of transition countries emerged after 1991, and the period of observation is too short to allow reliable calculation of growth rates (to be found in *Appendix 4*) for longer period and also too short to draw conclusions.

⁴ Colombatto & Macey (1999) offer an interesting explanation of these cases.

⁵ Tables with changes in growth rates from year to year for all countries are omitted from this paper to save the space.

On the other side, the IMF and World Bank statistics covers a number of smaller countries and territories: countries and territories with a population under 1 million outside Europe are excluded from this analysis.⁶

Table 1: Classification of countries according to average growth rates 1970-1999.

F			E			D			C			B			A		
Less than 0			0 - 1,50			1,51 - 3,0			3,1 - 5,0			5,1 - 7,0			More than 7		
Country	FI	HF	Country	FI	HF	Country	FI	HF	Country	FI	HF	Country	FI	HF	Country	FI	HF
Congo, DR	121	-	Ethiopia	-	124	USA	5	6	Canada	13	15	Mauritius	37	72	Botswana	50	69
Sierra Leone	119	-	Liberia	-	-	N. Zealand	3	4	Australia	6	9	Swaziland	-	79	Kenya	69	87
Bulgaria	79	95	Madagascar	111	86	Austria	15	14	Japan	22	18	Tunisia	78	66	China	81	114
Romania	118	126	Niger	97	112	Belgium	20	20	Ireland	7	3	Bangladesh	100	132	S. Korea	44	30
			Kuwait	42	43	Finland	14	25	Luxembourg	9	5	Hong Kong	1	1	Malaysia	58	76
			Poland	86	55	France	34	39	Portugal	27	33	Indonesia	73	116	Singapore	2	2
			Haiti	89	138	Germany	18	21	Spain	33	37	Laos	-	150	Oman	29	52
			Jamaica	80	56	Italy	25	32	Iceland	19	26	Thailand	54	28	Taiwan	40	22
			Nicaragua	35	108	Holland	10	8	Norway	26	38	Egypt	52	121			
			Trin.& Tob.	48	41	Denmark	17	16	Benin	92	63	Israel	57	54			
			Mali	94	71	Greece	38	49	Burkina F.	-	96	S. Arabia	-	78			
			Algeria	122	90	Sweden	23	31	Cameroon	99	91	Syria	116	143			
						Switzerland	8	11	Chad	104	120	UAE	49	19			
						UK	4	7	Congo, Rep.	107	127	Domin. Rep.	41	60			
						Burundi	103	-	Gambia	-	99						
						Ivory Coast	88	75	Guinea-Bis.	120	142						
						Ghana	87	84	Malawi	112	117						
						Mosambique	-	102	Morocco	74	51						
						Namibia	51	74	Nigeria	108	103						
						Rwanda	113	123	Uganda	45	80						
						Senegal	101	82	India	93	133						
						S. Africa	47	83	Myanmar	123	145						
						Togo	109	131	Nepal	90	111						
						Zambia	71	89	Pakistan	98	109						
						Zimbabwe	91	147	Papua N.G.	115	118						
						Mongolia	-	77	Philippines	32	81						
						Lybia	-	154	Sri Lanka	83	53						
						Hungary	43	42	Iran	105	151						
						Argentina	11	29	Jordan	53	64						
						Bolivia	12	36	Cyprus	65	24						
						El Salvador	21	12	Turkey	76	67						
						Peru	31	40	Brazil	96	93						
						Uruguay	55	34	Chile	16	13						
						Venezuela	77	119	Colombia	82	70						
									Costa Rica	24	46						
									Ecuador	66	107						
									Guatemala	56	50						
									Honduras	61	101						
									Mexico	63	73						
									Panama	30	45						
									Paraguay	39	92						

Appendices 1 and 2 present data on economic freedom collected by the Fraser Institute (FI) and the Heritage Foundation (HF).⁷ Presented data are compiled from different publications of the two

⁶ IMF does not provide data for some countries (like Taiwan), due to the problem of international recognition, and they are found elsewhere.

⁷ The Freedom House's index (cf. Messick, 1996) is omitted here for being biased, since it partially includes civil and political liberties into economic freedoms: freedom to earn a living, non-discrimination in employment, etc.

institutions.⁸ In order to provide compatibility with the FI-scale, the HF-scale - where 1 represents the largest and 5 the smallest degree of economic freedom - is transferred to a 0-10 scale, where 0 represents the smallest and 10 the largest degree of economic freedom. Smaller countries are not excluded from the tables of economic freedom, since this would violate the rankings. As indicated on several places bellow, the data related to degree of economic freedom are even less reliable than those on growth rates. Although there exists a problem of reliability, they are included in this analysis, since the alternative (i.e. to ignore them) sounds even less attractive. **Table 1**, reduces the number of countries to some 110, since three lists of countries do not coincide, and a number of countries is missing in lists when compared to each other.

Table 1 presents a classification of countries according to average growth rates in the period 1970-1999.⁹ Around 110 countries are divided into six groups (A – F), and to each country is attributed ranking on the list of economic freedom by the FI and HF.¹⁰ Not available data are represented by ‘-’.

If a country grows at rate 7.0% it needs approximately ten years to double its real *per capita* income. If it grows at rate 5% it needs some 14 years, while at growth rate of 2% it needs some 35 years to double the real income. In that light, wealth may be enhanced significantly in some country either by moderate growth rates, which last for centuries, or by higher growth rates during several decades. Unfortunately, economic freedom was not measured in distant past, and we do not dispose over such data in long-term series, so that conclusions can be drawn just from descriptions to be found in economic history. The FI-index covers 30, and HF-index just 8 years.¹¹

The content of the **Table 1** is surprising for anyone who expects to see the most free economies as the fastest growing at the same time. The majority of the most free economies (ranked up to 30th place on any of two lists) enjoys much more moderate rate of growth compared to a number of

⁸ Cf. Literature. For construction of the indexes, see: Gwartney a. o. 1996, p. 11-46; O’Driscoll a. o. 2000, 2001 and 2002, Ch. 5. Both FI and HF indexes measure economic freedom merely in legal terms and according to some macroeconomic indicators (money supply growth rate, customs rates, the level of black market activity, etc), rather just in how much purely legal framework, within which economic activity takes place, is suitable for business.

⁹ For a number of countries data on growth rates are not available for the whole period: column ‘Number of years’ in **Appendix 3** indicates the period which is covered with data. There is no point in calculating average growth rates where the data for majority of years are missing, where condition of some country changed profoundly (like in Iraq), or where countries broke up (Yugoslavia, Czechoslovakia). The HF ranking and indexes in **Table 1** are taken for 2001 (and not for 2002) in order to provide the temporal compatibility with the FI data, which stem from the 1999 year. The HF for 2001 is based on figures for a second half of 1999 and the first half of 2000.

¹⁰ There are huge differences in the FI and HF rankings. UAE are 49th (FI) and 19th (HF), Philippines 32nd (FI) and 81st (HF), Zimbabwe 91st (FI) and 147th (HF), Jamaica 80th (FI) and 56th (HF).¹⁰

¹¹ The eight year is 2002, which is excluded from calculations in **Table 1**. See Fn 9.

countries which grow for other reasons. The majority among the most free economies grows at the rate 1.51-3.0% in the period 1970-1999, while a larger minority from this group of the most free economies grows at rate a 3.1-5.0%. Among the slowest growing economies (groups E and F), there are just two moderately free economies (Kuwait, Trinidad & Tobago), while all other economies belong to illiberal ones. The most striking observation is related to the fact, that in both groups of the fastest growing economies relatively rare are those countries that grow exclusively due to larger liberalization. Among those in group B, to radical liberalizers belongs Hong Kong, while among those in group A there is just three radical liberalizers (Singapore, Korea, Taiwan). All four countries from the two extreme brackets according to growth rates belong to the Asian 'tigers'. Later on we are going to see that this has to do merely with changes in the tradable sector.

A detailed examination of changes in the degree of economic freedom inside some groups reveals interesting insights. The FI-index for countries which grow the fastest (group A) is on raise for 6 (Botswana, Kenya, China, S. Korea, Singapore, Oman) and in stagnation for 2 countries (Malaysia, Taiwan). The HF indicates a raise for 3, stagnation for 1, and a decline for 4 countries in economic freedom from 1995 to 2001. Actually, the four countries from this group, which had the highest index in 1995, are on decline in economic freedom over several recent years (Singapore, Taiwan, S. Korea and Malaysia). There are considerable difference in absolute numbers between the FI and HF indexes for all countries except S. Korea, Malaysia and Taiwan, and there are some differences between two indexes for period 1995-1999/2001: the FI indicates a raise for S. Korea from 7.0 to 7.1, while the HF indicates a decline from 7.10 to 6.90. Later on there will be a comment on developments in particular countries.

The FI index for the group B, which consists in 14 countries, indicates a raise in economic freedom for 8 and stagnation for 3 countries (for 3 countries there is no data). Short-term developments (1995-1999/2001) are more diversified: FI indicates a raise for 6 and decline for 5 countries, while HF indicates a raise for 6, stagnation for 4 and decline for 4 countries. FI and HF just partly coincide in estimating short-term fluctuations in economic freedom, and widely diverge in indicating the degree of economic freedom for 4 countries (Mauritius, Indonesia, Egypt, Dominican Republic). The number of countries with higher degree of economic freedom is rather small in this group.

The FI index for group C, which consists in 41 countries, indicates a raise in economic freedom for 19, stagnation for 14, and mixed results for 2 (Honduras, Papua New Guinea), and a decline for 4

countries. For Gambia and Burkina Faso there is no evidence. Short-term developments (1995-1999/2001) in economic freedom according to the FI indicate raise (12), stagnation (13) and decline (14), while HF indicates a rise in 16, stagnation in 15 and decline in 10 of altogether 41 cases. FI and HF coincide in just 16 cases by indicating the same tendency, four times (Chad, Republic Congo, Nigeria, Sri Lanka) they mutually contradict since one index indicates rise and the other decline, while in 16 cases there is significant difference¹² in indexes, taken in absolute numbers.

The FI index for group D, consisting in 34 countries (for 3 of them there is no evidence), indicates a raise in 23, stagnation in 5, and decline in 3 countries (Belgium, Switzerland, Venezuela). This is apparently the most successful group according to two indexes, not only in improving economic freedom but also in holding the highest level of freedom for longer, according to the rankings, but nevertheless it is growing relatively slow compared to three other previously reviewed groups. The old industrial countries in this group are clustered and their wealth is the result of stability and larger economic freedom over time, since wealth needs time to be accumulated. However, two factors prevent higher growth rates there – the emergence of new markets, and the activity of interest groups. By liberalizing tradable sector new markets attract significant private investment, and this is taken away merely from developed countries. Second, interest groups over time learn how to take advantage of the situation, what in combination with regulation, reduces economic freedom and growth rates. Short-term developments (1995-1999/2001) according to the FI show a raise in 16, stagnation in 11 and decline in 4 countries, while the HF indicates a raise in 22, stagnation in 8, and a decline in 3 countries. In 13 cases the FI and HF coincide in determining the trend in development of economic freedom, in 12 cases there are some differences in estimating the trend, and in 3 (Ghana, Togo, Venezuela) cases the FI and HF contradict to each other. Again, differences in absolute numbers between FI and HF are large in at least 7 cases (Greece, Namibia, S. Africa, Zimbabwe, Argentina, Bolivia, Venezuela).

Table 2: Average degree of economic freedom for 6 groups of countries.

¹² In some cases differences between estimates of two indexes are next to absurd (Iran, Philippines, Ecuador).

Group	F		E		D		C		B		A	
Growth rates	> 0		0 - 1.5		1.51 - 3.0		3.1 - 5.0		5.1 - 7.0		7.0 >	
Index												
Year	FI	HF	FI	HF	FI	HF	FI	HF	FI	HF	FI	HF
1970	-	-	-	-	6.37	-	5.89	-	5.31	-	6.54	-
1995	4.02	3.62	5.40	3.80	6.85	5.17	6.27	4.65	6.30	4.90	6.93	5.95
1999 or 2000	4.05	3.82	5.53	4.61	7.07	5.82	6.30	5.09	6.60	4.89	7.12	5.85

The level of economic freedom in two remaining groups (E and F) is too low¹³ to enable them to grow just due to the degree of economic freedom, so that they can be left aside here. It pays to take a closer look at the average degree of economic freedom inside 6 groups, presented in Table 2. It is easy to see that the FI index is higher for all groups (where the data are available) in 1995 compared to 1970, and that it is higher for all six groups in 1999 compared to 1995. This shows a generally rising tendency for economic freedom in the world, according to the FI. However, economic freedom in the world does not rise continually since 1970. It declines after 1970s, stagnates throughout early 1980s and raises again in late 1980s – what can be seen from data for the ‘world average’, *Appendix I*. The HF index is higher in 2001 than in 1995 for 4 slower growing groups (C, D, E, F), while indexes for the two fastest growing groups (A, B) are slightly lower in 2001 compared to 1995. Later mentioned fact does not change a general conclusion about improvement in economic freedom from 1970s to 2000s in terms of both indexes. The FI index is on average more generous in indexing the degree of economic freedom, than the HF is, since it allocates larger numbers to all 6 groups, both for 1995 and 1999/2000. Average difference between two indexes for 1995 is 1.28, and it is 1.10 in 1999/2000. The largest difference between the FI and HF exists for group B in 1999/2000 years, followed by the groups D and C in 1995. The smallest difference between two indexes is in group F. The largest difference between indexes for specific groups is for group B, followed by D, C, E, A and F. The average difference between two indexes for all 6 groups for both terms (1995 and 1999/2000) is 1.2 points, what represents 1/8 of the measuring scale, and calls for eventual revisions. The FI for

¹³ Kuwait and Trinidad & Tobago may be exceptions to some degree.

groups A – D indicates a rise in 56, stagnation in 24 and decline in 7 countries, while the HF indicates a rise for 41, stagnation for 31 and decline for 22 countries.

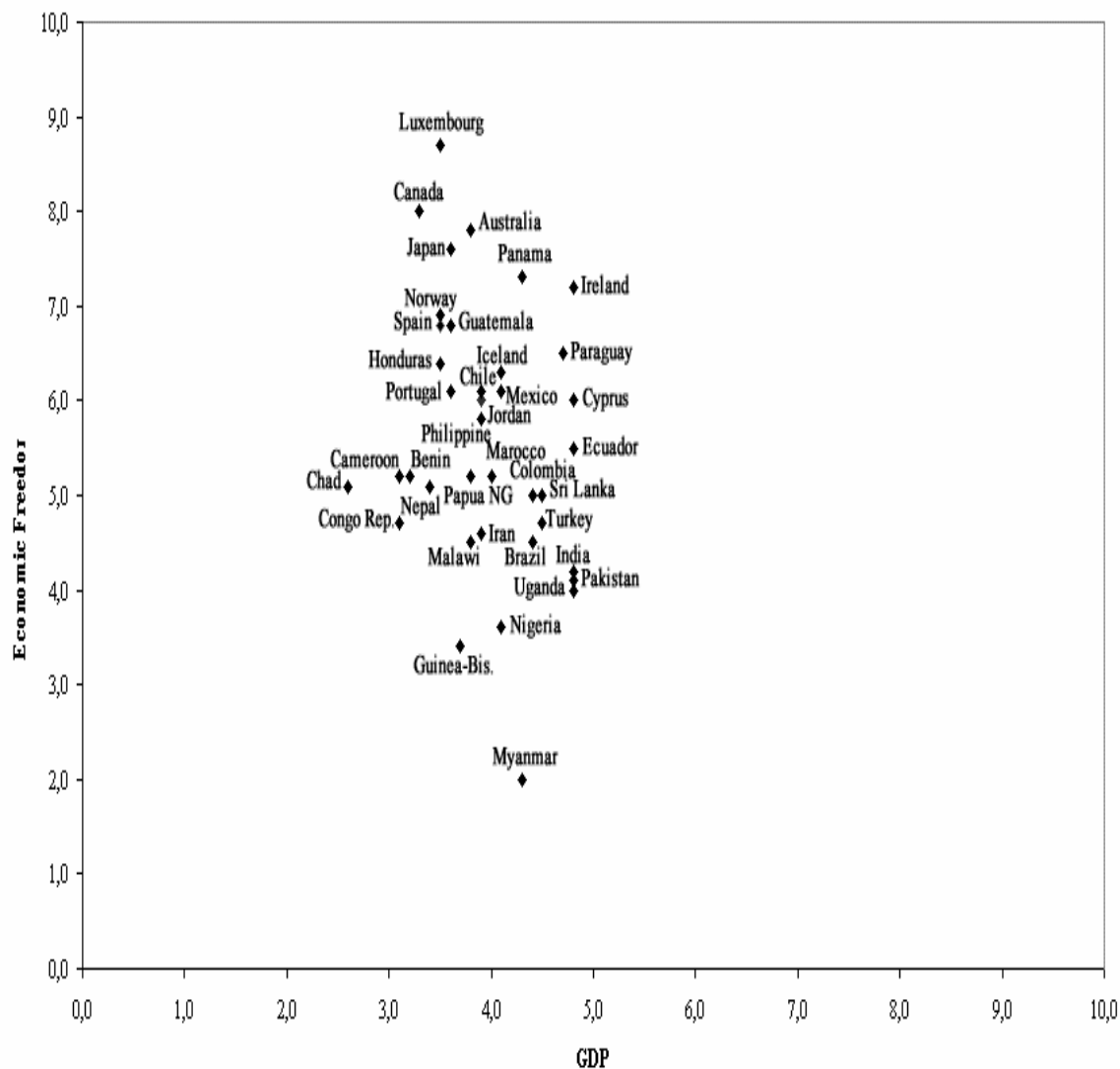
Special attention in the *Tables 1* and *2* deserve some data that show that economic growth and economic freedom do not go hand in hand. It is not true that the fastest growing economies (group A) are the most free in economic sense, what is easy to see from their ranking. Even worse, the difference in economic freedom between that group and the group D is next to negligent according to both indexes and for all years, while the difference between the group D and the groups B and C is large. The both indexes for the last two mentioned groups are again relatively close, although there should be some larger difference according to economic wisdom. The FI index for group C is higher for 1970 than for group B, while the contrary is true for 1995 and 1999. It may also mean that the group B has improved economic freedom more than other groups in the period 1970-1999. The theory ‘the larger freedom, the higher growth’ holds for groups F and E, since those countries with less freedom grow slower and since the difference in indexes of freedom for two groups is significant. That theory becomes even weaker with next two exceptions. First, the group D should be ranked second (i.e. before B and C) according the degree of economic freedom, and secondly, the difference in level of economic freedom between the groups B and C should be larger. Even without doing regressions, it is apparent that the relationship between economic freedom and economic performance is weaker than suggested in some recent papers.¹⁴ This may be seen from the figure below, depicting countries from the group C¹⁵, where Myanmar and Nigeria with very low degree of economic freedom enjoy higher growth rates than 2/3 of countries from that group. A number of countries from this group enjoys high degree of economic freedom and has relatively low growth rates.

The majority of countries in the two fastest growing groups (A, B) are not champions of economic freedom, and they grow either due to a large liberalization in the tradeable sector or for other reasons.

¹⁴ Cf. Gwartney a. o. 1999; O’Driscoll a. o. 2001; Hanke & Walters (1997).

¹⁵ Similar presentation for other groups is omitted, to save the space.

GDP and Economic Freedom, Group C



A number of other reasons may be responsible for growth too, like peace settlement after a civil or other war, the exploitation of natural resources or foreign aid. Economic sanctions and wars squeeze economies in question, by enlarging the risk for doing business, and by diverting resources to economically unproductive military actions, and that is why peace is followed by economic expansion. Many governments use war and sanctions as an excuse to increase the role of the state in the economy, by nationalization, rationing, introducing price controls or extending regulation. These moves are probably useful just for politicians and some interest groups, to increase their power and

wealth, while they are economically destructive, because they lead to inefficient solutions. These measures are also bad for military purposes, since it is better to have more efficient economy in war, than the alternative.¹⁶ Lifting sanctions or ending wars has expanding initial effect on the targeted economy. The potential of expansion based on peace settlement would be exhausted soon if not followed by some type of institutional reform, which is able to curb the growth. Economic expansion after peace settlement can be prolonged, even without institutional change, provided there is some other factor, like foreign aid – as many examples from the ‘third world’ show. Bosnia & Herzegovina is among the fastest growing economies in the period 1996-2002, but this is the result of peace accord in Dayton from 1995, and substantial foreign aid, rather than a liberalization of the economy.¹⁷ Instead to facilitate post-war recovery and stimulate the growth, foreign aid in the Balkan countries just came at the place of central plan, what enables the rulers to keep economies unchanged while pleasing the interest groups.¹⁸

Furthermore, some countries liberalize some branches of the tradable sector, like mining or tourist industries in order to take advantage in some area without exposing the whole country to liberalization, a move used by countries rich in minerals or abundant in tourist destinations. This partial liberalization sometimes results in booming these branches, and if the resources are abundant or if the rest of the economy is relatively small or underdeveloped, these booms can significantly influence the growth rates for the whole economy. The Arab countries rich with oil have liberalized its exploitation, while some other run tourist industries (Spain in 1960s, Madagascar, Maldives, Seychelles, Kenya or Tunisia). Large diamond producers, like Botswana, where the government reinvests revenues from diamond extraction to other branches, have had a significant GDP growth over decades, without any serious liberalization of the rest of the economy (although Botswana has improved economic freedom to a moderate degree). All these examples are naturally excluded from this analysis, which is restricted just to the cases of growth caused by a systematic enhancement in economic freedom.

¹⁶ Mises wrote along similar lines in *Die Gemeinwirtschaft*, 1922.

¹⁷ Cf. *Appendix 4*.

¹⁸ Claims for another Marshall Plan for the Balkans are completely misplaced for at least two reasons. First, private property rights were dominant, well defined, protected and enforced in the West Europe after the IIWW, what is not the case in the Balkans. Secondly, the West-European countries already were on sharp economic rise before the Marshall Plan (1948-51) started, and the Plan just facilitated recovery by adding a few percentage points more to growth rates, while such a rise is not to be observed in the Balkans today.

III) LOOKING FOR ANSWERS

A general rise in economic freedom from 1980s on came as a result of many factors, with previous development as a very important among them. For several decades before 1980s state direct and indirect interventions into economy expanded, and this proven to be harmful if not disastrous both for economic freedom and output. The expansion of statism brought about dangerous regimes, like fascism, communism and national socialism. The myth of the 'third way' dominated in undeveloped countries and among intellectuals on the West. A number of anti-market dictatorships existed along that story in Africa, Asia and Latin America.

Dissatisfaction with destructive effects of state interference into economy also played a role. Both large statist projects, the welfare state on the West and the Soviet planned economy on the East entered a deep crisis in 1970s. Some Western countries started reforms, partly triggered by external, oil shocks (1973, 1979), while for the Soviets there was no remedy, and the system collapsed, although they were not adversely affected by oil shock. Latin America became increasingly democratic, while the new markets were already on rise in the Far East.

Political and economic liberalization from 1980s on set the stage for mutual competition among different arrangements, which is sometimes called a new wave of globalization. It is a process involving the transfer of institutions, ideas, and cultural models not only between different civilizations but also even among Western societies themselves. By doing liberalization in tradable sector many countries created better business environment, relative to others, and attracted significant investment. Globalization in principle allows all possible economic solutions and all existing cultures to come into play, provided they show to be successful in competition with rivals. In a word, it allows institutional experiments. Some authoritarian or dictatorial regimes on the Far East proven to be successful economically, what induced other underdeveloped countries from the region to follow the suit. Similar role was played by Chile on the other side of the globe, so that a number of Latin American countries liberalized their economies during 1990s.

Different reasons are to be mentioned for why some countries after one move of liberalization have not continued that way, and just one seems to be universal. Since there is no change at no cost, pro-market reforms are considered to be costly, and voters in countries which have passed reforms seem to prefer to enjoy benefits flowing from reforms rather than to invest in a new wave of reforms, which need years to pay back. What concerns other reasons, it seems that there is no single unitary

explanation for all these cases. Instead, there are several factors like moves in democracy, tradable sector, the rule of law, which may play different roles in different countries. Similar economic history and similar other factors offer better criteria to cluster countries which did liberalization in some groups, than it would do current growth rates. Developed countries that enjoyed high degree of economic freedom for decades before 1930s would be one group. Economies from the Far East should form next group. Transition countries, again, have also to be treated separately, and the Latin America is a different case as well. The focus on these four groups covers the huge majority of countries that did liberalization during several last decades. Discussed are typical cases from these groups, rather than all countries in groups; while being time consuming, a more extensive debate would not seriously change conclusions.

a) Developed countries

Developed countries are to be found in *Table 1* in groups C (Australia, Canada, Iceland, Ireland, Luxembourg, Norway, Portugal, Spain) and D (Austria, Belgium, Denmark, France, Germany, Greece, Holland, Italy, New Zealand, Sweden, Switzerland, UK, USA). With exception of Ireland and Iceland, none of these countries grew above 3.8% during 1970-1999. They may have, however, higher growth rates in period 1860-1929.

State expenditures in developed countries before 1929 were just rare above 10% of the GDP, planning and regulation were strange words, rent-seeking and social transfers modest. Some of these countries eventually were economically more free in XIX century, and after experiencing a significant increase in economic freedom and consequent rapid growth they became more occupied with some other issues, putting aside further improvement of economic freedom and growth. However, after the Great Depression and especially after the IIWW, governments in the developed countries pursued policies that led to diminishing economic freedom, what corresponds to Hayek's label 'the road to serfdom', and what included the Keynesian policies of nationalization¹⁹ of productive assets, subsidizing inefficient businesses, expansionary fiscal and monetary policy, inflated currencies, high taxes, large social transfers, etc. Negative experiences with these policies (inflation, large deficits and debts, high taxes, fall in competitiveness, capital outflow) and external shocks during 1960s and 1970s induced a need to consider the change.

¹⁹ Although Keynes himself was against nationalization.

Britain and the **U.S.** were first with reforms during early 1980s, followed by New Zealand, Australia, Holland, Luxembourg and Ireland. In some other countries changes were not so dramatic and were not labeled as a reform. But at that time indexes for measuring economic freedom were not present; just the FI index was developed later on to cover these years retrospectively. The core of reforms in Britain consisted in privatization, tax cuts and restrictive monetary policy. Having not to privatize a lot, Reaganomics relied on tax cuts, reduced social spending and tight monetary policy. The U.S. reform, however, was not consistent like British, since it included some ‘demand side’ stimulations, like attractive credits for ‘durable goods’ (computers, for example), subsidies for car industry and the rise in military expenditures. Thatcher’s government undertook the largest privatization process up to that time in history,²⁰ and this newly coined word²¹ became obligatory for all reform programs throughout world, later to come. Privatization is one of the most important elements of continuing global phenomenon of the increasing use of markets to allocate resources.

After two years of post-reform recession and negative growth rates (-2.2% in 1980, and -1.3% in 1981), British economy started to grow (1.8% in 1982), and the growth reached its peak in Thatcher’s era in 1988 (5.2%). The U.S. economy has grown 3% on average during 1970-99, nearly 1-percentage point more than British, with just three years of negative growth during 1976-2000. Positive results of reforms, both in the U.S. and Britain, have, however not led to a new wave of liberalization. After reforms both the U.S. and Britain have remained without larger changes in institutional design throughout 1990s. Although changes in both countries took several years to be implemented, they were one-shot move. The labor government broke an 18-year rule of conservatives in 1997, and enjoyed the benefits of a strong economic inheritance. Between 1992 and 1997 the economy grew at average annual rate of 3.1% (compared to 2.7% in all OECD countries), while under New Labor GDP growth²² has fallen to 2.6% (OECD averaged in 3.3% in the same period), productivity growth has fallen from an average 2.3% a year before 1997, to 1.8% since 1997, the competitive position of the UK in the world economy deteriorated, Britain’s share of world exports has dropped over period 1997-2001 from 5.1% in 1997 to 4.5% in 2000²³. The tax burden rose from 34.3% in 1996-7 to 37.9% of GDP in 2000-1. Tax and social contributions now take

²⁰ Larger isolated moves before were denationalization of British steel industry in early 1950s, privatization of ‘Volkswagen’ in 1961 and ‘VEBA’ in 1965, and denationalization of some industries in Chile after the coup.

²¹ Peter Drucker has launched the world, to replace ‘de-nationalization’.

²² British growth rates, according to state statistics, were: 2.6% for 1960-73, 1.5% for 1973-9, 2.2% for 1979-89, 0.7% for 1989-95 and 3.1 for 1992-7.

²³ Center for policy studies - Labor’s economic record, at the site: www.cps.org.uk/stealth

46.1% of household income, up from 42.1% in 1996 and 1997, while household saving ratio have declined from 9.9% before 1997 to 4.9% since 1998. Despite a moderate decline in economic freedom from mid-1990s to 2000, both indexes show a moderate rise in economic freedom in Britain during this period.

American governments during 1990s have tried to revert some reforms, but after they faced lacking support to do that, they became progressively inactive. Both the U.S. democrats and the UK labor party reject the Keynesian policy on stimulation by boosting demand, but do not adopt free market approach. A small decline in economic freedom in Britain, which remained undetected by both indexes, is not the only responsible for worsening economic data; a change in power from pro-business to less pro-business party may also have some influence, which is difficult to measure. Business cycles or aging firms do have similar influence, but they are here outside the scope of interest. It is interesting that American democrats and British conservatives have lost elections in 2000 and 1997 respectively, despite booming economy, and British New Labor won elections in 2001 despite worsening economic condition, what reflects a weak relationship between the state of the economy and the outcome of elections.

While reforms in the U.S. and UK were primarily motivated by internal economic inefficiency, reforms in **New Zealand** and **Australia** during 1980s and 1990s were merely a result of external shock. After the UK entered the EU in 1971, Australia and New Zealand have lost the secure market and in order to find it elsewhere some internal reform was needed, in order to reduce state expenditures, enhance competitiveness and efficiency.

- Both countries entered 1980s with high tariffs, regulated labor market, fixed exchange rates, declining growth rates, declining exports, but before entering reforms the economic position of New Zealand was inferior to Australia, with high trade barriers, pervasive price, wage and capital controls, and a lot of social transfers. Almost all prices, interest rates and dividends were controlled by government, public ownership was widespread, income tax rates moved up to 66%, etc. As a result, GDP per capita slid from 92% of that in the U.S. (1938) to 50% (1950), and to 38% in 1984. Australia experienced less interference in the economy and better economic performance during the same period.
- The governments of both countries first refused to imitate Thatcher pro-market reforms, but due to a very bad micro- and macroeconomic performance (it was the time of the collapse of post-war

boom) changed mind and started reforms, which included, freely floating exchange rates, privatization, financial deregulation, labor market liberalization, public sector restructuring, etc.

- The Australian ‘trilogy commitment’ from 1984 specified, that “1) federal government tax revenue would not be permitted to grow as a proportion of GDP; 2) federal government spending would not grow faster than the economy as a whole, and 3) the federal deficit would be reduced in money terms in 1985-6 and would not be permitted to grow as a proportion of GDP in the following 2 years”. (Quiggin 1998, 80) The government was initially successful in keeping promises, but the ‘trilogy’ collapsed after the economy went into recession in 1989, and public expenditures expanded well above limits. Floating exchange rate was established in 1983, tariffs were reduced in 1988, privatization and competition policy (including infrastructure and utilities) took place in 1990.
- The labor governments in both countries implemented reforms, and to right-wing successors it has just remained to break the power of unions by deregulating labor market. This move completed the reforms, by allowing more flexibility on the labor market, what relaxed pressure on budget and tax policy.
- Government in Australia was more looking for suitable trade off between free market reforms and social security policies, than government in New Zealand. Due to different political and other conditions, the reform on New Zealand was faster and more consistent, while that in Australia was flawed, accompanied by some refurbishment of the welfare state: nevertheless, short term outcome following reforms was much better in Australia than in New Zealand. New Zealand experienced post-reform recession during several years, and it was similar to that what has been seen in transition countries in the East Europe during first reform years, i.e. 1991-4. But after N. Zealand and Australia did reforms, there was no new wave of liberalization there.

The post IIWW development of the **Greek** economy was reversed to the previously discussed cases, and it is instructive for all those looking to gather evidence about consequences of different economic policies. When other countries pursued Keynesian policies, Greece adhered to market, and when others turned to market, Greece succumbed into Keynesianism. Consequently, the Greek economic performance was impressive between 1954 and 1973, while after 1974 it has deteriorated. “During 1954-73 average annual growth were 7%, but annual inflation only 4%. Annual growth exceeded the OECD average by about two percentage points, yet inflation was the same as the OECD average. In the twenty years after 1974, the situation changed dramatically. Growth slowed in the late 1970s and collapsed after 1980. Inflation shot up and remained stubbornly high. Average annual

growth during 1974-93 was only 2%, slightly below the OECD average. Average inflation was 18%, over ten percentage points above the OECD average”.²⁴ Current deficit averaged in -2.1% for 1954-73, and rose to -4.5% for 1974-93. For a profound difference in outcomes is responsible a sharp change in economic policy.

Prior to 1974, Greece fostered private investment, guaranteed property rights and stability of rules of the game, and run low taxes, free prices and low import-export barriers, stable currency, fiscal discipline and balanced budget. By liberalizing the tradable sector Greece attracted investment and reached high growth rates. This regime degenerated during political dictatorship, and many of their elements were not sustainable under new social and political reality. Democratic rule²⁵ failed to recover elements of previous economic ‘success story’ opened the way to rent seeking on the large scale, and designed the system to result in ‘troubled economy’, by inflating currency, promoting the role of the state in the economy, supporting re-distribution, increasing debt, introducing distorted taxation, stimulating unionization of labor, re-introducing price controls, enlarging public administration, etc. Conditions for private investment deteriorated, but after entering in the EU in 1981 Greece got subsidies from Brussels - moving between 0.4% of the GDP in 1981, to over 5% during 1990s (on average 5bn US dollars per year), to compensate low private saving and investment. Subsidies just postponed necessary adjustments, by improving current account, allowing higher private consumption and lowered net exports. The results were mixed, since the country introduced heavy regulation typical for more developed EU members in 1990s, and to some degree stabilized the budget and currency in the second part of 1990s, what together with privatization has led to some improvements in economic freedom²⁶, but what remained apparently an insufficient move in order to get significantly better economic outcome. Better results would require another credible wave of reforms, to remove distortions that discourage private investment, what includes further privatization, liberalization, fiscal discipline, reduction in rent-seeking and currency stabilization - to mention just a few issues.

²⁴ Alogoskoufis, 1995, 150.

²⁵ Alogoskoufis feels that both economic and political regimes previous to 1974 were imposed, and that the restoration of democracy has been perceived as a triumph of left wing forces, so that changes afterward reflected concessions to these forces, independently of that which party was in charge.

²⁶ Greece is by far the worst off placed member of the EU on the list of economic freedom: HF ranks Greece 49th with 5.75 points in 2001 among 161 countries (Spain is 14th among the EU-15, and 37th among 161 countries with 6.50 points), while FI ranks Greece 38th with 7.3 points in 1999 among 123 countries in the world (again behind all other EU members; France and Spain are 14th and 13th with 7.5 and 7.6 respectively).

Greece shares some features with two other Mediterranean economies, Spain and Portugal, which have displayed slightly worse economic performance than Greece before 1974, and a better one since mid-1980s, what indicates that during relatively smooth transition from authoritarian regimes to democracy the economic performance needs not to be worsened. Portugal and Spain improved economic freedom more than Greece did, and have used subsidies from the EU for fiscal and structural adjustment rather than to postpone the both, as Greece did. If integration reveals the extent to which the country is non-competitive and requires costly adjustments, Portugal and Spain were hit less.²⁷ If the most successful transition countries decide at all to join the EU, what is against their economic interest, it is much better for them to follow the case of Spain and Portugal, than that of Greece.

Developed Western countries have been celebrated in contrast to the Soviets for their achievements in democracy, market economy and the rule of law. Many analysts were satisfied with this difference, and just a few authors have remarked at that time that the Western countries themselves undergo a degenerative change manifested in expanding the role of the state,²⁸ undermining economic freedom, enhancing rent seeking, weakening the rule of law. Looking back on this period one may conclude that democracy, statism and communitarian ideologies were in expansion, while market liberties and the rule of law were in contraction.

One may wonder for how far these degenerative tendencies in Western countries would go, if they have not had produced consequences which have threatened to undermine the vital values – individual freedom and individual welfare. Reforms that have started in the U.S, UK and N. Zealand in the 1980s have stopped degenerative tendencies and reverted partly the developments back to its original track, but they have stopped shortly of profound changes, apparently because they would be too costly. Eventual another wave of reforms will crucially depend on the relationship that is going to be established between democracy and the rule of law.²⁹ Positive developments are to be expected just if the rule of law is strengthened vis-à-vis democracy. This would not imply any restriction in

²⁷ Contrary to Spain and Portugal, where FDIs as percentage of GDP have raised temporarily after joining the EU and declined to the pre-membership level some nine years after joining the EU, FDI in Greece halved after country joined the EU, and have recovered to the pre-membership level after ten years of membership only, what reflects different business environments in these countries.

²⁸ The most of this expansion has been due to pensions, health care and social transfers.

²⁹ Both areas are frequently misunderstood as very similar, although they are mutually completely different. Democracy is about 'who rules?', while the rule of law is about the restraints that should be enforced independently of that who is in charge. Democracy ensures that preferences of individuals count in selecting ruling representatives, while the rule of law should protect individuals from interference of elected representatives into individual, property, minority and other rights.

general suffrage, but it does imply firm restraints on what the majority, its representatives and interest groups may do.

One line of improving the rule of law should consist in introducing further restrictions on what is allowed for majority to do about property rights, rather than about civic and political rights, which are merely well protected.³⁰

Another line would consist in reducing discretionary power of politicians and bureaucrats, i.e. the negative provisos in constitutions and laws are to be strengthened. Third, it should be strengthened provisos preventing collusion among different branches of power (executive, legislative, judicative), among those in power and interest groups, and among different vertical levels of government (municipality, county, region, federal unit, central government). Four, it should be prevented collusion between national governments and international organizations and associations. If there should be a priority, it would be in reducing regulation, institutional corruption and rent seeking, in the sense of looking for profit beyond market. Instead of planning which dominated between 1930s and 1970s, contemporary societies are plagued by regulation, what raises prices and changes incentives and allocation. Institutional corruption confuses demarcation between state, economy and NGO-sector, and it is especially fed by party finance³¹ and fund contributions, public purchases and public works,³² and by political logistics offered to domestic firms to operate abroad, merely in non-developed countries. Rent seeking is not only characteristic for poor people in a society, but to any group able to extract rents - the adverse effects of which appear with the time lag. Rent seeking is strongly positively correlated with the size of government, i.e. with the state expenditures.³³ Different kinds of rent seeking and redistribution reflect a growing demand among people for less competition, risk and uncertainty, and more security and stability. Economic outcome is no longer perceived as the responsibility of the individual, but it becomes progressively a matter of government and state. As this process of transformation goes on, the social and business climate

³⁰ With exception of rights being violated by relaxing rules for pre-emptive investigation and by allowing to state to collect information about all ordinary citizens, which are obtained via bank, credit, medical, social security accounts. Cf. Twight 1999 for the U.S. case, although it is not much different in other developed countries.

³¹ Cf. Colombatto 2001.

³² Cf. Jain 2001, p. 77-9, 82-3, 86-7.

³³ Both kinds of state spending have a negative effects on growth. Direct state spending reduces the volume of the cake, while vertical redistribution abounds in disincentive mechanisms. The greater economic inequalities are, the greater the pressure on government is for redistribution. Redistributive taxes - vertical redistribution - reduces growth both in democracies and non-democracies. Persson & Tabellini find that effect for democracies, while Alesina & Rodrik feel, it holds for all other countries.

became hostile to risk taking, entrepreneurial adventures, innovations and other steps felt as a nonconformist.

There exists space for further economic reforms: evacuation of state out of economy should continue by completing privatization of firms, by speeding up privatization of utilities and traffic facilities, by reducing regulation, by lowering state expenditures, taxes and social transfers, which became a supplement for planning, by eliminating subsidies and trade barriers, by extending privatization to health care, pension and educational systems, and by starting a denationalization of money in order to get rid of the state from its last economic monopoly.

If events are going to take another turn, if democratic demagoguery, communitarianism and statism are to be strengthened against the rule of law and market economy, than we are going to face a modern replay of what Hayek has described as 'the road to serfdom'. The statist model is about concentration of power, regulation and planning, hierarchy, harmonization, imposed convergence, cartelization and social engineering. Today's developed market democracies do not have an enemy to be used like a nasty example, like they once have confronted communism and national socialism. Rogue states and Islamic militants cannot be considered as a threat comparable to the Soviets, since they do not pretend to have alternative economic and political system, and since they lack means. In such a situation developed countries are exposed both to their mutual and outside competition, what makes future liberalization likely, if they do not want to enter a path of economic decline.

b) Japan and newly developed countries on the Far East

There is none Far East country in the slow growing groups D, E and F from *Table 1*, and the countries from this region are clustered in the two fastest growing groups – A (Korea, Malaysia, Singapore and Taiwan) and B (Hong Kong, Indonesia, Laos and Thailand). Exceptions are Japan and Philippines in group C. Although among the fastest growing economies, these countries are in the first half of the ranking according to economic freedom, but they do not belong to the most free in economic sense, with exception of Hong Kong and Singapore.

Case studies on the **Far East** economies have diverged largely in evaluation of results and policy recommendations, but one standard story to which economists subscribe is that of the export led growth. During 1950s these countries engaged in traditional import substitution policies, with multiple exchange rates, high level of trade protection, and repressed financial markets, while in the

late 1950s and at the beginning of 1960s this episodes of import substitution and foreign aid, mainly from the U.S., were over, what forced these countries to adopt export oriented policies. A new orientation included the unification of exchange rates, devaluation, measures to stimulate exports (duty free access for exporters to imported inputs), higher interest rates, and a moderate liberalization of import regime. This account has been criticized for neglecting the active role of government played in the Far East countries, without which is difficult to explain both the development and troubles later to come. Many authors believed that limited state interventions are very useful and even decisive for economic growth in the Far East, despite warnings, showing either that return to investment were inversely correlated with the degree of intervention,³⁴ or that state interventions had a negligent effect in changing the structure of production at the sectoral level and that the less intervention the better.³⁵ Wade (1990) has argued that governments have industrial priorities and intervened through subsidies, trade restrictions, administrative guidance, credit allocation of public enterprises to direct economy into desired direction. Tiger's governments arranged a significant increase in the private return to capital by removing obstacles to investment, promoting a sound investment climate, investment subsidies, administrative guidance and public enterprises. Liberalization in tradable sector made these countries more attractive for investment, compared to the rest of the world. Miracle resulted from capital accumulation and was slightly assisted by an increase in industrial factor productivity. Gross capital formation as percentage of GDP declined in Japan from 39% in 1970 to 26.3% in 1998. For an economy of that size Japan has low FDI and low investment abroad. Investment abroad moves 20-50 billion, while FDI moves 0.1-12 billion US dollars per year. State interventions emerged in response to agency problems during transition from labor intense to capital intense production, feels Lal, indicating that countries by choosing solutions at that point, also choose eventual troubles latter to come.³⁶ Anyway, the countries from the Far East managed to grow for decades, until the economic engineering fell victim of global competition and internal failures in design.

After decades of strong growth and despite high degree of economic freedom in tradable sector, **Japanese** economy stagnates during 1990s, and prolongs stagnation at the beginning of XXI century. The second largest world economy does not suffer yet from high unemployment, decline in income

³⁴ I. M. D. Little 1994.

³⁵ The World Bank 1993.

³⁶ Lal 1993.

or monetary devaluation; it suffers from declining growth rates³⁷, budget deficit at some 6% of GDP, public debt well above 100% of GDP³⁸.

Nikkei share price index fell by more than 50% during 1992-2001 and continued to fall during 2002, land prices fell for at least 25% during 1991-8, and wealth losses by economy 1989-97 came to 7 trillion US dollars, i.e. 200% of the GDP, of which some 50% was borne by households. At the same time (1992-5) the yen appreciated in real terms by 50%, what reduced competitiveness of the Japanese economy. Nominal short-term interest rates are zero in 2000-1, and deflation makes real interest rates positive.

Next to some other examples, Japan is a country that seems to be ranked higher on the list of economic freedom, than it deserves. Solutions advertised as the 'Japanese way' are not bad in itself, but it is bad if these solutions fail to create their own devices for some common problems:

- Instead of lifetime employment,³⁹ firms should be allowed to adjust labor force according to demand and supply for it. Workers should be paid according to absolute standards, and not relative to each other; Workers should be promoted according to results rather than according to the rank, determined according to the length of tenure, what causes that aging labor force increases the costs. This will develop active and liquid external rather than internal labor market, what is now the case.
- By opening the market to multinational corporations local business class will be prevented to develop indigenous state-linked conglomerates, like in Korea.
- Banks have to reduce long term lending and risk sharing, which reduce the quality of lending and encourage moral hazard. Especially 'main bank' arrangements have to be changed, since they develop above-mentioned bad incentives to an extreme. For example, if long-term bank-firm relations combined with stable shareholding are well and effective, why it is used just by half of all listed firms, many of which have stable debt? Why is growing the number of firms that try to avoid 'stable' networks, going to the external market for credits and having fewer 'stable' shareholders?

³⁷ Average growth rates for Japan in period 1950-2000 was 5.7%, and it is higher than in the USA (3.2%) and Western Europe (3.3%). However, growth rates in Japan in 1950-73 and 1973-90 were 8.8% and 3.8% respectively, compared to just 1.3% in 1999-2000 and -0.2% in 2001. Cf. Boltho & Corbett 2000, p. 2. The figure for 2001 is an estimation. The data for growth rates mentioned by the Japanese Ministry of international trade and industry are even slightly higher: for example, the growth rate was 10% between 1955 and 1972.

³⁸ If one takes into account the balance sheets of other public financial and non-financial institutions, the debt ratio would rise to over 170%, and allowance for unfounded pension liabilities would push it to over 200% of GDP.

³⁹ Firms massively over-invested and over-hired in the 'bubble' period, and as a result have large surplus labor. It is estimated that just surplus labor of this sort amounts in some 3% of working population, although real figures cannot be known until real adjustment takes place.

- It is not desirable that banks control firms to which they borrow, since the objectives of firms and banks are different: banks encourage firms to borrow more than profit maximizing strategy would require, to invest with low risk (and consequently, low return), and to develop minor changes in existing products rather than experiment with new products, what holds these firms far away from new profitable businesses.⁴⁰ This is not just objection to the Japanese model, but to the German one as well. If banks are so good in monitoring firms, how it is possible in Japan that they are unable to recover such huge amount of loans?
- In many cases ailing banks were supported by their stronger peers, and were not allowed to go out of business (bankruptcy). This ‘convoy system’, fed by strong family and friendly ties, shows how costly tastes could be cultivated at the expense of others.
- Banks have to eliminate their non-performing loans, whose size in 1998 was put at 10% of GDP⁴¹, and which have grown to more than 20% of the GDP in 2001.
- The dominance of large firm-networks, with underdeveloped external and labor markets, generated bad environment to creation of new (small and medium sized) business, provided bad incentives for innovation and poor environment for risk takers. Aging large firms tend to have lower returns, and this cannot be changed by inducing newcomers, until entrance in business is easy.
- Horizontal ties between firms that cement the existing relationships, stimulate monitoring and prevent hostile takeovers, have to be broken, what will directly encourage the competition among firms, and indirectly among managers and workers.

There are several alternative explanations of Japanese economic troubles,⁴² like strong reliance on supply side, unfavorable shocks, imbalance between savings and investment, money supply. But it seems that the main reason lies in relatively lower attractiveness of Japanese business environment. Monetary reasons cannot be dominant, since falling prices and the appreciation of currency despite some other economic troubles indicate a strong demand for yen. The Bank of Japan is rightly reluctant to easy monetary policy, advocated by some economists, since this would just postpone the main problems by putting them under the carpet for some time. It would 1) temporarily improve the export position of the country, 2) encourage currently weak entrepreneurial dynamics, 3) stop deflationary pressures on prices and wages, 4) create excess supply of money and stimulate spending,

⁴⁰ The birth rate of companies in Japan declined from over 6% in the early 1970s to 3.7% in 1994-6. Cf. Imai & Kawagoe, 2000, p. 115.

⁴¹ Debts to banks amount 150.000 billion yen (ca. 1250 billion US dollars).

⁴² Cf. Special issue of the **Oxford review of economic policy**, vol. 16 (2000), 2, pp. 1-123.

5) avert further real estate devaluation, and what is probably the most important, 6) it will relax pressure on some institutional solutions that need adjustment. Options are clear: institutional change is much likely with continuation of current monetary policy, but it puts the burden of costs just on the internal scene, what is neither liked among voters nor among politicians, while the expansive monetary policy would shift a significant part of this burden to Japan's trading partners, which will not be silent to such eventual move. Monetary solutions will apparently not work there where problems to be solved are created elsewhere. Instead of facing competitive markets for all factors of production, like capital, labor, intermediate products and services, firms became related to other actors (worker, union, investor, supplier) through long-term, risk-reducing contracts, which were profitable for some time, but which now have to be changed or the crisis will be prolonged and its costs enlarged. A development of external market would mean not just a retreat from the 'Japanese model'; it would also have some striking consequences - for workers, managers and politicians. Let us review some other cases before coming to general points about the region.

It is sometimes said, that some developed and newly developed countries have already reached a high level of economic freedom, and a further significant advance is not easy to achieve, if at all. This suggestion sounds dubious; although the possible progress in improving economic freedom is not endless, since we live in a world of imperfect property rights and positive transaction costs, these costs in principle may be reduced much more than they are reduced up to now in any of the existing countries. After Japan, let us demonstrate this on the case of **Singapore**, which is considered in our days as a blessing of 'free market'. It is true that governments there were export and growth oriented, but the development there was a matter of technocratic social engineering and not of free market forces. Activities in several vital, tradable sectors were planned and heavily subsidized, and nearly every segment of economic and social life was tightly regulated. Let us review some evidences.

EDB (Economic Development Board) was introduced in 1961, prior to gaining independence in 1965, by Singapore's first development plan to promote investment in metal engineering, shipbuilding and repair, electrical and chemical equipment. Periodic plans are a matter of intentional design that should lead toward some aim specified in advance rather than free market institutions. EDB run large enterprises, and due to a small internal market tended to attract foreign investment. Despite larger privatization during 1980s, state ownership in 500 largest firms accounted for 22.9% of assets in 1990, and some 14% in 2000, what by far exceeds state ownership share in Western countries.

Singapore created full employment scheme and supported education in order to facilitate the move from capital extensive to capital-intensive activities. The country was moderately successful in this: capital and labor inputs grew faster in Singapore than in Hong Kong, while total factor productivity growth has contributed significantly to economic growth in Hong Kong and little in Singapore.⁴³ Hong Kong followed a more liberal solution than Singapore, by letting its firms - including the industrial structure - to evolve nearly spontaneously, and because of that, it was more successful in performance measured by the productivity of capital.⁴⁴ During 1960s and 1970s Hong Kong relied on manufacturing, while during next two decades the country moved to economy based on high-tech, finance, trade and services.

Compulsory saving in Singapore was ensured via Central Provident Fund (CPF), which collected 30.1% of all savings in 1990, while CPF-members were entitled to buy cheap apartments, constructed by state owned AHS (Approved Housing Scheme). “By 1990, 90.2% of the population owned their homes and 85% of them lived in publicly built housing”. (Jones 1997, 287) This indicates very high state activity in constructing apartments, higher than in some communist countries, and much higher than any Western country. Individual ownership on apartments is severely restricted - a number of apartments was taken without compensation from owners after being privatized, either due to ‘indecent behavior’ or for allowing some physical objects to fall down from windows and terraces.

Although it is said, private property is secure in Singapore, in reality, it is neither secure nor so good protected.⁴⁵ Governments in Singapore enforced not just strange housing habits, but were politically oppressive and even pursued eugenic policies: they have used sterilization as a method of population control, in order to preserve full employment and high living standard. Political entrepreneurs other than from the PAP (People’s Action Party) were prohibited or strongly restricted, and the governing party changed electoral laws, as it wanted in order to preserve the power. Political authoritarian regimes produced several political crises, but they have not fueled economic instability as in many other countries.

Above mentioned details show, if anything, that beyond notorious aversion to democracy, government was not guided by free market and the rule of law. Governing philosophy rather was a

⁴³ Cf. Jones 1997, 289.

⁴⁴ Lal & Myint 1996.

mixture of 'Asian communitarian values', Fabian socialism and technocratic planning, while Western liberal individualism was considered as subversive.⁴⁶

The FI index grants between 9.6 and 9.8 points (from maximal 10.0) to Singapore, what creates an illusion that further advance in economic freedom in this country is not possible: whatever improvement done, it can not be larger than 0.4 to 0.2 points, what is negligible.⁴⁷ The HF index gives a maximum score (i.e. 10.0) to Singapore for both 'property rights' and 'regulation', but it also notes: "...the government's policy of limiting or even banning the circulation of periodicals critical of government policy is an infringement on commercial rights, not to mention the rule of law."⁴⁸ Preventive detention or nationalization of private apartments are not mentioned, but with or without that is evident that Singapore can not get 10.0, and that this score may eventually be appropriate for a nation of angels in a minimal state. For today's real-world countries which more than others promote pro-business environment the comprehensive index of economic freedom can be around 5.0 or 6.0 rather than close to 10.

By contrast to Hong Kong, **Taiwan** was reluctant to allow foreigners the control of vital sectors of the economy, what reflects a sensitive foreign political position of this country, and sought to provide control over economy, promoting native Taiwanese economic power, especially in capital-intensive branches - petrochemicals, ship building, etc.

Taiwan's Fourth Plan (1965-8) envisages that "/F/or further development, stress must be laid on basic heavy industries (such as chemical wood pulp, petrochemical intermediaries, and large-scale integrated steel production) instead of end product manufacturing or processing. Industrial development in the long run must be centered on export products that have high income elasticity and low transaction costs". (Quoted in Wade, 1990) As a result, firms from these sectors were less productive and less competitive. During 2001 Taiwan's growth rates dropped below 0%,

⁴⁵ The HDB (Housing Development Board) has to approve "renovation, rental and resale, forbids the conduct of business in units and has the right to evict residence found guilty of morally inappropriate behavior, not necessarily with compensation for their equity in unit". C. Y. Lim, cited according: Jones 1997, 287.

⁴⁶ "A non-liberal, communitarian democracy" (term coined by B. H. Chua) relies on mass mobilization against an external threat, by communists in 1970s, by "an irredentist China" in 1980s, and by the U.S. "as a root of all decadence". In a country where administrative laws prevail over the rule of law, with 'an efficient secret police', "...over 1000 Singaporeans suspected of vice related activities.../has been held/ ... in indefinite 'preventive detention' in 1997". Cf. Jones 1997, 295.

⁴⁷ To illustrate some details, FI gives to Singapore for "transfers and subsidies" (labeled Ib) 8.0 as a rule, 10.0 for "government enterprises" (Iia), what would mean that there is no such firms, 10.0 for the rule of law (Vb) in 1980, 1995 and 1999, 9.1 and 9.5 for legal security (Va) in 1970 and 1999 respectively. Cf. **Economic freedom of the world: 2001 Annual report**, p. 37 at the web-site: http://www.fraserinstitute.ca/publications/books/efw_2001/

⁴⁸ Cf. **The 2000 Index of economic freedom**, p. 406.

unemployment rose from 2.9% to nearly 5%, while Taiwan Stock Exchange has fallen from 8600 to 5000 during period 2000-2001. Taiwan's economic situation was additionally influenced by political uncertainties, after Kuomintang lost the political control over the country, after Chen Shuu-bian from the Democratic Progressive Party became the president, what indicates a need for transition to a more complete democracy, what is needed in order to avoid that political uncertainties fuel economic troubles. However, democracy may have adverse effects, like in Greece. Even there where it is able to stabilize political life and indirectly economy as well, it may enlarge rent seeking and in other ways reduce economic freedom. Democracy in itself is neither necessary nor sufficient condition for growth and prosperity.

Before the crisis in **Korea** became manifest in 1997, the country was successful for decades in export led growth. During 1960-80s the government sought to concentrate private wealth via production of giant firms (chaebols). These firms were subsidized with wastage allowances⁴⁹ and credits, arranged by politicians and granted by state banks. Politicians were able to buy votes of those who get jobs in subsidized firms, banks were happy to borrow to firms which have secured foreign market even below market interest rates, since they were compensated by legislators and politicians with favorable tax schemes and other benefits, and chaebols were happy to get cheap support, not available for them on the market. Politicians have somehow monitored chaebols, merely by testing them on export success. It is predictable that under such schemes chaebols would tend to be rent seekers rather than profit seekers, and that this mechanism will weaken progressively their competitive and productive abilities in any new round of investment cycles, and so cumulate mistrust that such a model is able to survive for longer. It is a matter of local environment contingency when borrowers start to feel that a line of reasonable risk has been crossed, and that confidence of investors does not exist anymore.

Exports have subsidized foreign consumers and the question posed was who is going to pay the price for subsidies. It took time until this question was raised in 1998 in such a sharp form that demanded prompt answer, and it was not surprising: domestic equity owners, those who had Korean money in pockets and international non market funds have had to pay the debts. Shareowners were asked to pay, since their shares lost the value to significant degree, banknote owners were heavily taxed by devaluation of the Korean currency, and foreign community (via IMF) paid to prevent even larger crisis, which could affect the international financial system. The message from this case was

⁴⁹ The wastage allowances provided an export subsidy of 4.6% in 1968, and up to 17-21% in certain fabrics and footwear.

simple: the debt created by flow of money into private pockets of one group of people (bank managers, owners, politicians) was paid by another group of people and from anonymous international ‘financial community’. If the former could be considered as a kind of local redistribution and so as a domestic political question, the latter simply tells us “just spend the money, the more the better, there are always somebody to cover the debt”. No wonder that there was a huge debate on how to reform the international financial system in order to prevent this plague to spread.⁵⁰

Countries from the Far East are different from other developed countries for several reasons. Just Japan was developed among them before IIWW, while other ‘tigers’ have started their development in two waves – in early 1960s (Hong Kong, Taiwan, Korea...) and in late 1980s (Malaysia, Thailand, Indonesia). Second, since ‘tigers’ were relatively small markets, the only option for rapid development was through exports. Third, export led growth was staged by visible, rather than by invisible hand. Fourth, and with exception of Japan, all ‘tigers’ were non-democracies. By implementing development strategies under non-democracies, rulers faced less resistance than they would otherwise do, and there was much less rent seeking than it would be under democracy. Fifth, the visible hand did some mistakes in design of institutions (beyond that of allocation), and the removal of these devices is costly, since they have caused large distortions in the economy, affecting powerful interest groups. How particular countries have passed through the Far East crisis depended on how well they were able to adjust to a changed situation. Small countries like Hong Kong and Singapore, with no natural resources and with tiny interest groups, tended to be more familiar with market solutions, while Taiwan and Korea were more reluctant toward imitation of such approach because of strong interest groups and out of foreign policy worries.

It seems that countries from the Far East did significant liberalization in the tradable sector, what has improved their position relative to other countries, and so they have attracted significant FDI, while non-tradable sector have remained less liberal. The relatively liberal tradable sector explains ‘export led growth’, while some solutions in tradable sector and non-liberal solutions in non-tradable sector explain why these countries were not at the top of rankings in economic freedom. This model worked well during 1960s-1980s, and came into crisis in 1990s, since the Far East countries stagnated or even declined in economic freedom, compared with others.

⁵⁰ It is proposed, among others, that investors and local debtors rather than ‘the international community’ should bear the costs, that the IMF should reduce rather than enlarge funds for interventions, that moral hazard and adverse selection by credit allocation should be discouraged, etc.

Protectionism⁵¹ would fit better to these countries than free trade, and it would be supported by owners/shareholders, politicians, employees and a large part of voters, but this development is unlikely until globalization goes on. By doing liberalization in tradable sector after the IIWW, the countries from the Far East did nothing to enhance economic freedom further on, by removing strange solutions in tradable sector and by liberalizing to some degree non-tradable sector. During several recent years they slowly decline in economic freedom even in the tradable sector, and it is not going to be easy for them to reverse the trend, since this would require abandoning the model, and that was one for which it was widely believed to be extremely successful. What was attractive for businesses once upon time, needs not to be attractive under changed circumstances and new emerging markets.

c) Transition countries and China

Transition countries as a group did the largest advance during last decades in improving economic freedom, but this is to be explained merely by low starting point. Transition in Central and East Europe is a common name for a process of transformation for some 27 states which basically but not exclusively consists in a move from dictatorship, the rule of one party and command economy, to democracy, the rule of law and market economy.⁵² Transition countries represent apparently different case from those previously discussed, since changes in the design of economic institutions were just a part of total change of the regime. Some states were even (re)born during post-communist transformation. Even some elements of reform, like the legal reform and privatization, as the very heart of reform, are more complex, difficult and all encompassing in transition countries, than they are in either developed or non-developed countries.

Economic part of transition, despite variations, relies on some policies which usually include: privatization of the state owned enterprises and letting emerge a new private sector, liberalization of foreign trade, freeing prices and internal market, fiscal and budgetary reform, stabilization of currency, fighting black market, crime and corruption, and encouraging transparency, sound corporate government and private investment. It is unlikely that the reform moves are going to be spontaneous and self-enforcing, since a number of social groups opposes reform moves. This does

⁵¹ Protectionism is, naturally, bad economic policy, and it will 'solve' problems for a while rather than in the long run.

⁵² More about that in Prokopijevic 2001.

not represent a plea for social engineering or an activist role of the government, since the government, after imposing minimal rules of the game, should restrict its role to the referee. Although policy recommendations move more or less around the same objectives, the conditions for reform implementation widely diverge, depending on many factors like political situation, history, habits, macroeconomic situation, rulers' attitude to reform, success in constitutional reform and the rule of law, etc. Having all that in mind, advances in transition countries ranged from modest relaxation of previous rules to radical pro-market reforms. The European transition countries were more successful in transition reforms than ex Soviet republics, where partial reforms produced mixed or adverse effects. The Baltics seem to be the most successful in reforms, followed by central European states, Balkans, Russia and Central Asia. The champions of liberalization among transition countries according to the FI are Estonia (ranked 36th, with index 7.4), Hungary (43rd, 7.1), Latvia (46th, 7.0), Czech Republic (60th, 6.6) and Lithuania (62nd, 6.5).⁵³ The HF ranked in 2002 the most economically free countries in the following way: Estonia (4th, 8.00), Lithuania (30th, 6.60), Czech Republic (32nd, 6.50), Hungary (33rd, 6.50), Latvia (40th, 6.25), Poland (52nd, 5.75).

The smallest degree of liberalization among transition countries the FI indicates in Albania (102nd, 4.7), Ukraine (106th, 4.6), Russia (117th, 3.9) and Romania (118th, 3.8), and the HF in Tajikistan (137th, 2.90), Ukraine (138th, 2.90), Bosnia & Herzegovina (140th, 2.75), Yugoslavia (144th, 2.40), Uzbekistan (149th, 1.60), and Turkmenistan (150th, 1.50)

Champions of liberalization among transition countries are not necessary leaders in economic performance. In terms of GDP average growth rates in the period 1992-2001, see *Appendix 4*, Albania (5.4%), Poland (4.6%), Slovenia (4.1%), Slovak Republic (3.5%), Croatia (2.9%), Hungary (2.5%) and Czech Republic (1.8%) fare better than others.⁵⁴ According to Foreign Direct Investment (FDI) as percent of GDP, Turkmenistan (21.95%), Azerbaijan (19.52%), Moldova (16.59%) and Latvia (12.12%) are ahead of others. Measured in the absolute amount of FDI, Russia is on the top, followed by Poland, Czech Republic, Hungary, Kazakhstan and Romania.⁵⁵ In some countries, however, there is a huge unregistered influx of foreign investment, like in Ukraine or Kazakhstan.

⁵³ Cf. *Appendices 1 & 2*.

⁵⁴ There is none transition country in groups A, B and C from *Table 1*; Hungary belongs to D, Poland to E, Bulgaria and Romania to F. If measures from *Table 1* have to apply on countries growth rates 1992-2001 from *Appendix 4*, Albania would belong to B, Poland, Slovenia and Slovak Republic to C, Croatia, Hungary and Czech Republic to D, while other countries would be in groups E and F.

⁵⁵ Extended analysis on performance of transition countries is to be found in the journal *Transition*.

In terms of the facts above, the theory ‘the larger liberalization, the better’ works pretty bad, and there are several reasons for that. First, the period under observation is ten years, and this is too short, both for economic freedom and macroeconomic data. Second, such a total change of the economic system causes deep post-reform recession. Third, countries in transition face a profound change that abounds in mutually contradictory events. Fourth, among transition countries nearly every of them is a special case,⁵⁶ what makes generalizations difficult to draw. Fifth, if statistics during communism has overstated figures in order to meet requirements of the central plan and to impress the public, official transitional statistics is different in quality from country to country, and it underestimates the growth in areas where small companies dominate,⁵⁷ what is related to tax evasion. Sixth, by combining several criteria the most liberal economies come at the top.

Among important factors for a successful transition are political situation, personal reform staff, familiarity with the rule of law, macroeconomic performance and history. It follows a brief comment in the same order.

Political situation refers to at least three factors. First, how long reformers have spent in power, and second, what were the strength, unity, and determination of pro-reform forces while being in power. Non-communist (or non ex-communist) reformers have spent surprisingly short period in charge during transition throughout the Central and East Europe.⁵⁸

There have been no major concern with the performance of ex-communists in regard of preserving and strengthening democracy, while their return to power slows down market reforms, and it is accompanied by an outflow of FDI⁵⁹, rising interest rates, inflation, deficit and debt, decline in investment, productivity and GDP. It is also accompanied by slowing down privatization and institutional reform. By having in mind how communists were instrumental about the legal system it does not surprise that recycled communists do not care much about the rule of law. On the other side, the reformers were more successful where they have spend more time on power – with the Estonia,

⁵⁶ Some countries were involved in war or secessions, some enjoyed significant support from abroad, some economies are so poor and extensive that an investment of 50 million dollars makes some 20% of GDP, some are heavily indebted, some have significant mineral reserves, some dispose over population with solid working habits and skilled workers, etc.

⁵⁷ Figures miss a large part of growth in agriculture, food processing, wood processing, retail trade, tourist and restaurants industries, leather working, textiles, and many areas dominated by face-to-face services.

⁵⁸ In the Czech Republic, reformers spend 1990-6 in power, in Poland 1991-3 and 1996-9, in Lithuania 1990-3, and after 1997, in Hungary 1990-4, and 1998-2002, in Estonia 1992-5, and 1998-2001, in Bulgaria 1991-4, 1996-2001. In contrast to that, in some other countries like Albania, FRY or Romania, the socialist rule has nearly not been interrupted despite several elections during 1990s.

⁵⁹ With exception of the Czech Republic, where ex-communists have changed in the restrictive FDI-law, and after that FDI jumped from \$ 1.7 billion to over \$ 5 billion per year.

Czech Republic, Lithuania, Hungary and Poland as examples. Another factor was how united pro-reform forces were by reform agenda,⁶⁰ and how determined to profound change. More compact reform blocks and greater commitment apparently matter, since such countries fared better. Third, the breakdown of communism is apparently very good moment for profound reform, since interest groups who oppose reforms are either weak or non-existent at that moment. They need time for organization, and once they are strong enough, further liberalization becomes more costly than before. This explains “one shot move” during reforms. But it explains something else, too. Weak constitutional constraints provide incentives for politicians and interest groups to get rents. The chance for fast and deep reform existed there, where the old interest groups have collapsed, while the new ones have not emerged quickly enough – like in Czech Republic, ex GDR,⁶¹ Baltics or Hungary.

The rule of law becomes a critical factor, having in mind both its absence during communism and the rent-seeking (corruption) opportunities under democracy. It is unlikely, that one country after communism may adopt and enforce the rule of law to such a degree, as we know it from the U.S. or UK. The rule of law cannot be simply imported, and if adjusted to local situation, it requires many years to develop to a significant degree. The weakness of the rule of law during several years or decades may be exploited either from interest groups or from the rulers. However, if interest groups are not politically influential, and if rulers have other preferences than buying time while being in charge, or practicing manipulation and corruption, there is nobody to exploit the absence of the proper rule of the law, and reforms can work better than expected.

In such a situation personal solutions concerning those in charge become an important factor. Countries with committed reformers in power, like Vaclav Klaus in Czech Republic and Mart Laar in Estonia, did better than those where reformers were engulfed by semi-reformers and rent-seekers. And they both did better in their institutional change, than countries whose leaders were hesitant about reforms, or those whose leaders used reforms just for their own businesses, and which succumbed in corruption and crime.

There is a wide conviction among economists, that it is easier to reform a country with less disequilibria, than the alternative one. It is easier to do reforms where inflation, budgetary deficit,

⁶⁰ Reforms in Romania, Ukraine (twice), Moldova or Macedonia failed because disputes in the pro-reform coalitions, which emerged after first larger pain from reform became manifest.

⁶¹ Reforms in ex GDR failed, for being a classical example of social engineering, and the best index of that failure are yearly transfers from the West Germany to ex-GDR, which move between €55 and €75 billion per year. Creators of these ‘reforms’ have forgotten, that although people from both sides of the German border are Germans, they have had during

public debt, unemployment rate are lower, where exports and imports are balanced, where GDP is higher, where firms have not lost their markets, etc.

In the most successful transition countries (Hungary, Estonia, Czech Republic) exports are based up to 80% on FDI, and they need to avoid mistakes done by Far East countries. First, they need to liberalize both tradable and non-tradable sectors, in order to avoid the large gap between them to emerge, which frustrates inter-sectorial trade. Second, they need to liberalize enough to stay competitive. Third, in doing so they need to avoid imposing strange institutional solutions, because it is difficult to remove them later on. This is not likely until transition countries radically break with the past.

Finally, history and habits matter. As many authors from North and Arrow to Buchanan and Pejovic indicate, it is impossible to implement formal, reform rules that are in conflict with prevailing informal rules among population. People spontaneously resist to such imposition, and market democracy offers better environment for defection compared to the previous communist regime, where non-cooperation was much more costly.

Up to now, larger liberalization in transition countries, where it has happened, was merely one shot move, i.e. large jump toward enhancing economic freedom was followed by small adjustments over years, and these adjustments in some cases increased and in other cases decreased economic freedom. The only exception from this rule is probably Estonia, which has one extra large, and two other large moves in enhancing economic freedom. For nearly all transition countries there is a rule: if there was no enthusiastic reform at the beginning of transition, later reforms were halfway, and produced the modest or even adverse outcome.

The absence of permanent liberalization may be explained by huge reform costs: people expect to see benefits after they have survived both permanent shortage under communism and a very painful post-communist change, rather than to be asked for second time to pay. Second, during several opening transitional years there emerge interest groups, which tend to exploit advantages of changing rules in their favor. Opposition groups consist of ex-communists and other transitional losers, and transitional changes are not in their interest.

To sum up, 'majority rule' in combination with weak constitutional constraints became an open channel for government intervention into economy, either on behalf of rulers or on behalf of interest

past 70 years different habits, different macroeconomic situation, and different history. Democracy and the rule of law provide people and firms with better safeguards against engineering measures, which they do not like to accept.

groups. Governments were able to pursue any policy, from deep and consistent reform to next to no reform at all. The best reforms happened in countries familiar with the “work ethic” where old interest groups were dismantled, while new have not become politically influential, where the rule of law was high among the reform agenda, and where rulers were committed to reforms rather than to bribe and corruption. Nearly none among above factors has worked well throughout the ex-Soviet Empire. Russia and Ukraine are well example of reform fatigue after failed reform, which is blamed for large privatization manipulation and disastrous social consequences.

In Russia, some 70% of manufacturing firms were initially transferred to workers and managers, i.e. to insiders. The subsequent evolution of the ownership structure in the direction of outsiders control was moderate, and it was the result of free choice of some insiders to sell their shares. Large owners, oligarchs, made their money not through asset stripping manufacturing firms, but through their privileged access to cheap credits from the Russian Central Bank, and through preferential privatization of natural resources⁶² – they earned by selling at the market prices abroad what they bought at the controlled domestic natural resource prices. Corrupt transfers of wealth to ‘oligarchs’ on the one side, and the failure of insiders privatization on the other side, which was predictable, have strongly contributed to the political unpopularity of privatization and reforms altogether in Russia.

All transition countries faced a fall in output after collapse of communism, with a difference that those implementing serious reforms were in recession 1990-94, while those that were not reformed have stayed in a prolonged recession. The fall in output was deeper among non-reformed countries, with Ukraine as a champion of recession, which remained on economic decline⁶³ for the nearly whole period 1989-9, during its rough-and-tumble transition, with two failed reform attempts in 1994 and 1998-2001.

With the demise of communism people in these countries have faced absolute freedom in making choices for forthcoming period. Those who were lucky to select larger economic freedom and to improve the rule of law have paid through transition recession at the beginning of reforms, but came on the path of prosperity relatively soon; those who refused to pay the costs of serious reform have to stay far away from such a path; they saved for reform costs but they will pay by living in backward economies.

⁶² During 1995 Russian government applied ‘loans for shares’ scheme, which transferred control of 12 natural resource firms to a small group of ‘oligarchs’, and did that at the very low prices, what naturally raises doubts about corruption.

The case of **China** is different from transition stories, because it cannot be considered as a post-communist country. China has preserved the communist system, and it was able to grow at rate 8-9% on average in period 1978-2000, in time when the Soviet Empire either was in deep crisis or even collapsed.

China's economic expansion was a result of a triumph of moderate reformists over hard-liners inside the Communist Party, which have liberalized some areas of economic life. Credit allocation was decentralized (in some periods more than in others), some regions were open to limited and controlled capitalism (economic zones Shenzhen, Zhuhai, Shantou and Xiamen), private firms, euphemistically called "non-state-owned", were allowed to exist,⁶⁴ exchange rates were unified and partly free, fiscal system was reshaped, state expenditures declined from 31.3% of GNP in 1978, to 11.9% in 1994, foreign trade and internal markets were liberalized as well. Although the tradable sector is geographically restricted to small areas, China has attracted significant FDI, because of the size of the market. It was predictable that under conditions the economy will grow, what actually happened, with the two peaks of growth - 14.5% in 1984, and 14.2% in 1992.⁶⁵ China's per capita income has nearly quadrupled in the last two decades. This development was facilitated by the fact, that China never had a real planning system, as it became known from Russia, and that the country was decentralized in 1970s.

Less attention among analysts has attracted lower rates of growth, near or even below 5%, in other periods, for example in 1981, 1989-90. Even less remarkable was, that periods of raise in growth were accompanied by accelerating inflation (with time lag of ca. 1 year, and with peaks in 1985, 1988, 1994, followed by slowdowns and decline of both - growth and inflation rates. What happened?

Among other things, liberalization brought a relaxation of control in credit allocation process, and it relaxed control over state owned banks to invest into non-state-owned sector, "the investment share of this more productive sector rose, causing the entire economy's growth rates to rise". (Brandt & Zhu, 2000, 431) This widened the gap between relatively successful non-state-owned sector and

⁶³ Ukraine's GDP grew by 8.2% in 2001, after 5.8% growth in 2000, the first year of growth since 1989.

⁶⁴ Chinese firms are heavily burdened with social welfare and heavily regulated: "...only one third of the stock in China's publicly listed former SOEs can be owned by individuals; the remaining two-thirds of a company's shares must be owned by the state and by domestic (usually financial) institutions – which are invariably state-owned. So-called 'A-shares' may be owned and traded only by Chinese citizens, while B-shares are stocks listed in Shanghai and Shenzhen that may be owned and traded only by foreigners. Other shares are listed in Hong Kong (H-shares) or New York (N-shares), and these are also restricted to foreigners". Megginson & Netter 2001, p. 365.

⁶⁵ Cf. WEO 1999, p. 177.

relatively unsuccessful state owned sector. Since Chinese authorities use the state owned sector as the economic basis of their power, they were forced to grant transfers to state sector, in order to preserve employment, wages, and fresh capital there. To do this, communist authorities needed more control over banks, what led to a de-liberalization in the sector, to issuance of more credits, what at the same time causes inflation and rising growth rates.

Since the state owned sector is relatively inefficient and in order to prevent hyperinflation, authorities need to switch again to more restrictive monetary policy, to decentralize again the credit allocation, etc.

This is actually stop-and-go policy and it cannot be employed forever. The gap between two sectors becomes larger with the flow of time, what raises the price for maintaining the game. Bankruptcy law was rarely applied to Chinese state owned firms, although there were a number of cases to apply it, since this sector was already shrinking, and there was a huge underemployment of the rural labor force. For some time, government will be able to control the gap via monetary and investment policy, but since the gap tends to be wider, at one point these measures will be ineffective, and the authorities will face the alternative: either to allow normal operation of the non-state-owned sector which will wipe out state owned sector (in industry, the state owned sector share of output accounted for 43% in 1993, down from 78% in 1978)⁶⁶ completing transition to market economy, or to reintroduce hard line policy (control of prices, wages and interest rates, nationalization of the private sector, tight control of exports and imports, etc., what would mean a come back to hard line socialism.

True, the Chinese economic system, based on decentralized bureaucratic dirigisme, evolved more toward market economy than any economy from the ex-Soviet Empire during 'reforms' from 1960s on to the end of communism, but it needs more profound reform to become a real market economy. If geographic and arbitrary restrictions on the movement of productive factors and disposition over profits are to be removed, and if market was subjected to the rule of the law, that could pace the way toward peaceful transition to a kind of market democracy. This positive trend may be enhanced by China's accession to the WTO. If this occurs, a number of heavily protected (subsidized) sectors of Chinese industry will be opened to outside competition, what again will reinforce the pressure for further privatization and reforms.

⁶⁶ Cf. Qian 2000, 160.

d) Developments in Latin America

Beyond isolated, but highly publicized case of Chile, developments related to economic freedom & growth-issues in Latin America are merely neglected. The initial reform in Chile in the midst of 1970s was imposed by pro-market economists inside the dictatorial regime, and despite some shortcomings in design, it produced good economic results. Contrary to many other countries, Chile gradually improved economic freedom from 3.5 points in 1975 to 7.9 in 1995, while after that the degree of economic freedom stagnates in period 1995-2001 (according to the FI).⁶⁷ Other Latin American countries, both democracies and dictatorships, have not only failed to produce any significant economic results during 1970s and 1980s, but some of them drove their populations into backwardness.

Long time after Chile, several other Latin American countries during 1990s have liberalized their economies to a larger degree, showing this way that Latin Americans are not hostile to economic freedom *en masse*. Eventual problems may stem from elsewhere, i.e. from the weak constitutional provisions. According to the FI, countries that did larger liberalization are Argentina, Bolivia, El Salvador, Costa Rica, Panama, Peru and Nicaragua, while according to the HF, these countries are Argentina, El Salvador, Uruguay and Bolivia. They were followed by a number of countries that liberalized to a moderate degree. These reforms are relatively recent and due to a time lag and general instability of the region, one needs to wait to see eventual results. Contrary to Chile, other Latin American countries did liberalization in a democratic environment: some countries did reforms after a very long stagnation under democracy (Uruguay), some after leaving dictatorships or authoritarian regimes (Argentina, Bolivia, Panama, Venezuela), some after hyperinflation (Bolivia, Peru), and some even after destructive (civil) wars, like El Salvador, Honduras, Nicaragua.

A number of small countries and territories – like The Bahamas, Barbados, St. Lucia, Antigua, Cayman Islands, Aruba, etc. - with larger degree of economic freedom operates in and around the Latin America, and they are well known as ‘tax heavens’. They play extremely useful role on the international fiscal and financial scene, by offering escape for individuals, market funds and banks from countries with heavy tax burden and tight regulation, what prevents these already ‘expensive’

⁶⁷ However, according HF it raises in the same period from 6.00 to 7.50 points, with jumps in 1997, 2000 and 2002. It is also to be noted that Chile did further advances in liberalization after returning to democracy.

countries to raise some taxes even more. Today's 'tax heavens' are not really minimal states, what concerns the size of the government; they are rather insufficient, *ad hoc* and transitory move in a good direction. 'Tax heavens' borrow some public goods, including security, either from their mother countries or from international organizations. Some also take advantage of their geographic location, while offering better business environment and favorable tax conditions.

Despite some positive developments in the recent period, and contrary to many optimistic analysts of the Latin American-affairs, it does not seem that troubles in this region are over. An indication is the lower HF index in ranking the Latin American countries in 2002, compared to 2001.⁶⁸ Even though the majority rule has taken root in the Latin America, the rule of law is merely absent. Instead to constrain government activity, the Latin American constitutions and laws are either ineffective, very generous to those in charge or both. One even may say, while the U.S. constitution abounds in restrictions to the government activity, the Latin American constitutions abound in permissions and generous provisions. Weak constitutions allow, if they do not stimulate, both rent seeking and predatory policies. Different social groups in looking to take advantage at the expense of others induce activist politicians on the political scene⁶⁹, which promise to revert previous injustice, and to promote policies in favor of poor people. Once elected, these politicians immediately complain, that they are allegedly prevented by constitutional constraints to deliver their promises. More power will invite more corruption and privileges, rather than more just policies, whatever this should mean. By having in mind the self-interest as the dominant motive among politicians, it is clear what they will do by facing the choice to act on behalf of their pockets or to act on behalf of other's pockets. This explains why the number of the Latin leaders ends in jail or in exile, although they were considered as democrats and semi-reformers while being in power. If the government has enormous power to do whatever it considers necessary for the 'poor', 'nation' or 'public interest', this country actually will slide toward socialism. Injustice from today, with reference to already imprisoned former leader, what is in itself a powerful marketing trick, calls for reverting this process tomorrow, what launches a competition for more redistribution (injustice) in the next round? Less numerous groups look for protection from the socialist policies elsewhere – in police and army. This

⁶⁸ Aside of Chile and tiny states like Bahamas, Trinidad and Tobago or El Salvador, which have improved the score and ranking in 2002, other better placed Latin American countries in 2001 have worsened both their score and ranking in 2002: El Salvador is down to 18th (from 12th), Argentina down to 38th (29th), Uruguay down to 41st (34th), Bolivia down to 47th (36th), Peru down to 54th (40th).

⁶⁹ "Elected leaders have power – even the responsibility under the law – to transfer wealth arbitrarily, and it is thus natural that voters elect those who promise the most generous transfers". O'Grady 2002, p. 3.

explains why Latin American dictatorships rely on guns rather than on ideology, what is different to the communist countries from the East Europe, where rulers have preferred ideology, and guns were used just to back up the ideology. The consequence from the above is that democracy in Latin America even in XXI century, instead to reduce, keeps political risks active, and this happens due to absence of strict and tight constitutional constraints and corresponding enforcement of rules, rather than due to an intrinsic weakness of democracy.

Bad development is to be observed in rise of popularity of socialist movements and politicians⁷⁰ throughout the continent in 2000s, what is the social background for forthcoming reduction in economic freedom. Socialist and rebel movements gain popularity also in some countries that have introduced programs to enhance economic freedom during late 1990s. Even economic reform and success that follows it, seems to be unable *per se* to prevent political instability, which would in turn end the economic liberalization, with Venezuela as a vivid example. Liberal reforms imposed by rulers having discretionary power are in danger, if they are not followed by synchronized moves to enlarge the rule of law (to restrain the government activity), by social policies to relief the reform pain, and by a raise in the social acceptance of the reform. C. A. Perez assumed presidency in Venezuela in 1989, when GNP was negative (-8.6% according to local data or -7.8% according to the IMF), inflation at 90% annual rate, and unemployment rate at nearly 10%. The country was heavily indebted (ca 27 billion US dollars), corruption was rife, and oil revenues in free fall and state owned sector dominated the economy. Perez introduced enthusiastic pro-market reforms, by freeing prices, removing restrictions on foreign trade, privatizing state owned enterprises, what resulted in market boom, currency stabilization, employment rise, and the growth rates 6.9%, 9.7% and 6.1% for 1990, 1991 and 1992⁷¹ respectively. On the wave of civil unrest triggered by the rise in public transportation prices, political demagogues initiated military coup, and in 1993 assumed the power, reintroducing pre-1989 policies. Average growth rates declined from 7.6% for 1990-2 to 0.13% for 1993-1999.⁷²

⁷⁰ Alan Garcia is back in power in Peru, the Peronists are back in power in Argentina, Hugo Chavez's rule in Venezuela got confirmation on elections in 2001, what confirms that the coup from 1993 has had popular support, former guerrillas (Daniel Ortega and FLMN) gain popularity in Nicaragua and El Salvador, populists L. I. 'Lula' da Siva and Horacio Serpa are on rise in Brazil and Columbia respective, etc.

⁷¹ The evaluation of the degree of economic freedom for Venezuela by the FI indicates less dramatic change than expected, by giving 6.1, 5.7, 4.2 and 6.1 points for 1985, 1990, 1995 and 1999 respectively. The HF index does not cover the years in question, but gives less points, and indicates - contrary to the FI index - a decline in economic freedom in Venezuela from 1995 (5.00) to 2001 (3.60), and 2000 (3.40), what implies 130th place on the HF list.

⁷² Economic decline and failed promises explain the growing calls for H. Chavez to leave office, what asks 53% of population. Cf. *Chavez launches hunt for military dissidents*, **Financial Times**, February 22, 2002, p. 4.

While the majority of Latin American countries that have liberalized followed the scenario of the 'one shot move', Chile and some 'tax heavens' are exception of that. Economic freedom there has increased during several moves. It is easier to explain how this happened in 'tax heavens' than in Chile, since these countries do not run welfare state and democracy, so that rulers (governors) simply do liberalization until their countries become attractive for foreigners.

IV) CONCLUDING REMARKS

If advances in economic freedom lead to growth and prosperity, is not logical to assume, that more growth would lead to more liberalization? And if so, is not logical to expect a rising popularity of permanent liberalization policies, for simply to capture the benefits that flow from constant liberalization? The answer to both questions is negative. Neither growth caused by liberalization induces further liberalization (putting aside some isolated cases), nor is liberalization a permanent policy in any state.

This does not deny that that economic freedom is essential for economic growth and prosperity, and it does not deny that liberalization policies would be highly productive and so desirable. It just denies that economic policies follow economics' textbooks.

Even worse, after doing liberalization in one period of time, some countries have entered the path of systematic and deep de-liberalization, like Greece in 1970s or Malaysia in the late 1990.

There is natural objection that some states have reached next to maximum in economic freedom , so that further liberalization is not possible. It seems, however, unlikely that countries that have reached a higher degree in economic freedom cannot make further advances. Today's countries operate on a much higher level of transaction costs, than that would require a minimal state⁷³ even with moderately generous provisos on spending. The brief analysis of Singapore and Japan makes the case for possibility of further liberalization, and other countries are not exception. One may even object that both the HF an FI allocate too high indexes to the freest economies, higher than they actually deserve, what again indicates that both indexes are biased to the current level of economic liberalization. Having in mind that the transaction costs are much higher from a necessary minimum, especially what concerns state expenditures, firm and banking, insurance or labor market regulation,

excessive taxation, the existing countries should not get probably more than 5 - 6 points on the 0-10 scale, with less liberal regimes getting proportionately less.⁷⁴

It seems that countries can pursue unproductive policies for longer time without falling the victim of disintegration and civil war. In order to get a violent outcome from the economic crisis one needs to see some additional factors, like deep ethnic, religious or cultural differences, the threat from outside, etc. Populations of some countries live in poverty for centuries without being involved into the civil war or decay of basic rules, and some of them eventually promoted poverty into national defense system, since any conquest followed by an occupation becomes costly and offers nearly no advantage to conqueror, like situation with Tibet.

The main reason for absence of enthusiasm for liberalization policies among politicians and voters is that these policies are costly in the short term, and that benefits flow in the long term. There is no reform at no cost, and if some reform takes place for any reason, both politicians and voters prefer to take advantage of that reform results, than to do a new costly investment into another round of reform. A while after reform, it emerges and stabilizes a new institutional design and a new configuration of interest groups, which exploit the newly established setting, and with flow of time it becomes progressively difficult to introduce new changes. Even where economic freedom has flourished for some time, there is no guarantee that this will last for long.

The period of liberalization brings with itself a decline in rent-seeking opportunities and produces more wealth, what in the next move gives an incentive to politicians other than liberals themselves, to offer voters more rents in exchange for political support. This mechanism shortens the political life of liberal politicians.

Due to huge costs involved, reforms are one shot move, and there are just a few exceptions from that rule in the observed period 1970-2002. That reforms are one shot move does not mean that they happen overnight. Liberalizing reforms are extremely complex happenings that require coordinated moves over entire institutional structure, what means that a move in one field requires a number of adjustments in other fields. They are related to significant costs, and – as Machiavelli witnesses above – they face significant opposition, and just lukewarm support. For these reasons liberalizing reforms last between 6 and 10 years, and sometimes exceed this range. As it is said, just a

⁷³ To establish a criterion of the minimal state, one may run different ideas, either by going along some theoretical constructions, like Hayek's 'spontaneous order' or Nozick's 'minimal state', or by going on his own and saying, that is a state, which ceases to exist when one additional monetary unit is subtracted from necessary finances.

few countries were successful in doing more than one move in liberalization, and these are Chile, Estonia and Ireland.

The interaction of democracy and the rule of law is one major factor in explaining what goes on in modern societies. In non-democracies, rulers determine policies, and they will promote liberalization just in the case they think it is in their interest, what is rarely the case.⁷⁵ Naturally, democracy is neither necessary nor sufficient condition for economic liberalization and prosperity, since there are prosperous non-democracies and non-prosperous democracies; democracy is, however, able to influence economic issues significantly, and it depends on the rule of law to which degree this is going to happen. Where the majority rule is strongly constitutionally constrained and subjected to the rule of law, rent-seeking opportunities are modest and the discretionary power of those in charge is small. There, where constitutional constraints for majority rule are weaker, rent-seeking activities flourish while discretionary power enhances redistribution and corruption. The effects of becoming democracies on some prosperous countries from the Far East and the transition countries are ahead, since both groups became democracies just a while ago.

A relative suitability of some country as a business environment is another major factor. Capital and some other factors of production are very mobile today and they go where they are more efficient. Private investment rather than donations and foreign aid is decisive for economic growth and prosperity. Strange institutional solutions, the gap between tradable and non-tradable sector, and legal instability frustrate investment and trade. More time is needed to become the rule of law, than to become a democracy. And the wealth needs time to be accumulated.

During last several years developed countries stagnate what concerns economic freedom, transition countries are on rise, while the Far East and Latin American countries are on decline. This temporarily weakens institutional economic competition, but this may be a break before a new wave to come.

LITERATURE

Abramowitz, M. (1983) *Notes on international differences in growth rates*, in: Mueller (Ed.)(1983), pp. 79-89.

Alesina, A. & Rodrik, D. (1994) *Distributive politics and economic growth*, **Quarterly journal of economics**, vol. 109, pp. 465-490.

⁷⁴ And it is also unlikely that any country can get 0 (zero), although it sometimes happens on the HF list: this would mean that the economic activity has reached a standstill, what is unlikely despite all prohibitive measures of some government.

⁷⁵ Cf. Colombatto & Macey 1999.

Allesina, A. a.o. (1997) **Political cycles and the macroeconomy**, Cambridge, MA: The MIT Press.

Alogoskoufis, G. (1995) *The two faces of Janus: institutions, policy regimes and macroeconomic performance in Greece*, **Economic policy**, vol 20, pp. 149-184.

Barro, R. J. (1996) *Democracy and growth*, **Journal of economic growth**, 1, 1, pp. 1-27.

Boltho, A. & Corbett, J. (2000) *The assessment: Japan's stagnation - can policy revive the economy?*, **Oxford review of economic policy**, 16, 2, pp. 1-17.

Brandt, L. & Zhu, X. (2000) *Redistribution in a decentralized economy: growth and influence in China under reform*, **Journal of political economy**, 108, 2, pp. 423-439.

Colombatto, E. & Macey, J. (1999) *Information and transaction costs as the determinants of tolerable growth levels*, **Journal of institutional and theoretical economics**, 155, 4, pp. 617-42.

Colombatto, E. (2001) **Discretionary power, rent seeking and corruption**, Torino: ICER. Available at: <http://www.icer.it>

Farr, W. K. a. o. (1998) *Economic freedom, political freedom, and economic well-being*, **Cato journal**, 18, 2, pp. 247-262.

Fedderke, J.W / Kadt, R H. J. de / Luiz, J. M. (2001) *Indicators of political liberty, property rights and political instability in South Africa: 1935-97*, **International review of law and economics**, vol. 21, pp. 103-134.

Financial Times, *Chavez launches hunt for military dissidents*, February 22, 2002, p. 4.

Gastil, R. D. (1978) **Freedom in the world: political rights and civil liberties 1978**, N. York: Freedom House.

Gwartney, J. D. a. o. (1997) **Economic freedom of the world 1997**, Vancouver: Fraser Institute.

Gwartney, J. D. a. o. (1999) *Economic freedom and the environment for economic growth*, **Journal of institutional and theoretical economics**, 155, 4, pp. 643-663.

Hanke, S. H. / Walters, S. J. K. (1997) *Economic freedom, prosperity and equality: A survey*, **Cato Journal**, 17, 2, pp. 1-23 (Internet: <http://www.cato.org>).

Harberger, A. C. (Ed)(1984) **World economic growth**, San Francisco: ICS Press.

Imai, Y. & Kawagoe, M. (2000) *Business start-ups in Japan: problems and policies*, **Oxford review of economic policy**, vol. 16, 2, pp. 114-123.

* * * **International financial statistics yearbook**, Washington: IMF 2000.

Jain, A. K. (2001) *Corruption: a review*, **Journal of economic surveys**, vol. 15, 1, pp. 71-121.

Jones, D. M. (1997) *Asian values and the constitutional order of contemporary Singapore*, **Constitutional Political Economy**, 8, pp. 283-300.

Lal, D. (1993) **The repressed economy. Economists of the 20th century series**, Aldershot: Edward Elgar.

Lal, D. & Myint, H. (1996) **The political economy of poverty, equity and growth**, Oxford: Clarendon.

Lindbeck, A. (1995) *Hazardous welfare-state dynamics*, **American economic review**, 85, pp. 9-15.

- Little, I. M. D. (1994) **Trade and industrialization revisited**. Iqbal memorial lecture, Karachi: Pakistan Institute of Development Economics.
- Meggison, W. L. & Netter, J. M. (2001) *From state to market: A survey of empirical studies on privatization*, **Journal of economic literature**, vol. 39, 2, pp. 321-389.
- Meltzer, A. (2000) *Monetary policy in the new global economy: the case of Japan*, **Cato journal**, vol. 20, 1, pp. 69-72.
- Messick, R. E. (1996) **World survey of economic freedom 1995-6**, New Brunswick: Transaction Publishers.
- Mueller, D. C. (Ed)(1983) **The political economy of growth**, N. Haven: Yale UP.
- Naughton, B. (1995) **Growing out of plan: Chinese economic reform, 1978-1993**, N. York: Cambridge UP.
- O'Driscoll, G. P. a. o. (2000) **The 2000 index of economic freedom**, Washington: Heritage foundation & The Wall Street Journal.
- O'Driscoll, G. P. a. o. (2001) **The 2001 index of economic freedom**, Washington: Heritage foundation & The Wall Street Journal.
- O'Driscoll, G. P. a. o. (2002) **The 2002 index of economic freedom**, Washington: Heritage foundation & The Wall Street Journal.
- O'Grady, M. A. (2002) *Too many promises*, at the: <http://www.heritage.org/index/2002/chapters/chap2.html>
- Olson, M. (1996) *Big bills left on the sidewalk: why some nations are rich and others poor*, **Journal of economic perspectives**, 10, 2, pp. 3-24.
- Pejovic, S. (1999) *The effects of the interaction of formal and informal institutions on social stability and economic development*, mimeo.
- Persson, T. & Tabellini, G. (1994) *Is inequality harmful for growth?*, **American economic review**, 84, pp. 600-621.
- Prokopijevic, M. (2000) **Konstitucionalna ekonomija (Constitutional economics)**, Beograd: E press.
- Prokopijevic, M. (2001) **Transition**, Turin: ICER Working Papers, Available at: <http://www.icer.it>
- Prokopijevic, M. (2002) *Social capital during transition*, Trento: Trento University working papers.
- Qian, Y. (2000) *The process of China's market transition (1978-1998): The evolutionary, historical and comparative perspectives*, **Journal of institutional and theoretical economics**, 156, 1, pp. 151-171.
- Quiggin, J. (1998) *Social democracy and market reform in Australia and New Zealand*, **Oxford review of economic policy**, vol. 14, 1, pp. 76-95.
- Rodrik, D. (1999) *Where did all the growth go?*, **Journal of economic growth**, 4, pp. 385-412.
- Scully, G. W. (1992) **Constitutional environments and economic growth**, Princeton: Princeton UP.
- The World Bank (1993) **The East Asian Miracle**, N. York: Oxford UP.
- Twight, C. (1999) *Watching you? Systematic federal surveillance of ordinary Americans*, **The independent review**, vo. 4, 2, pp. 165-200.
- World economic outlook**, October 1999, Washington: IMF.

Appendix 1:

Economic freedom of the world 1970-1999.

Rank 1999	Country	1970	1975	1980	1985	1990	1995	1999	Average 1970-99	Tendency
1	Hong Kong	9.5	9.4	9.7	9.3	9.2	9.7	9.4	9.5	S
2	Singapore	7.8	7.6	8.0	8.4	9.0	9.4	9.3	8.5	I*
3	New Zealand	6.9	5.6	6.4	6.3	8.0	9.0	8.9	7.3	I**
4	Un. Kingdom	6.4	6.3	6.6	7.9	8.4	8.7	8.9	7.6	I**
5	USA	7.7	8.0	8.4	8.5	8.8	8.7	8.7	8.4	I*
6	Australia	8.0	6.5	7.4	7.8	8.0	8.4	8.5	7.8	I
7	Ireland	6.8	6.1	6.6	6.7	7.3	8.6	8.5	7.2	I*
8	Switzerland	8.8	7.9	8.3	8.6	8.4	8.3	8.5	8.4	S
9	Luxembourg	9.1	9.1	8.9	9.2	8.2	8.3	8.4	8.7	D
10	Netherlands	8.5	7.1	7.8	7.9	8.2	8.4	8.4	8.0	S
11	Argentina	6.4	3.1	4.7	3.9	5.3	7.5	8.3	5.6	I*
12	Bolivia	-	-	4.1	3.8	6.3	7.7	8.3	6.0	I***

13	Canada	8.0	7.3	7.9	8.1	8.4	8.0	8.2	8.0	S
14	Finland	7.7	6.2	6.9	7.2	7.6	7.9	8.1	7.4	I
15	Austria	7.1	6.0	6.7	6.7	7.4	7.6	8.0	7.1	I
16	Chile	3.6	3.5	6.0	6.2	7.3	7.9	8.0	6.1	I***
17	Denmark	7.2	6.3	6.5	6.7	7.7	8.0	8.0	7.2	I
18	Germany	8.0	7.3	7.7	7.7	8.1	8.0	8.0	7.8	S
19	Iceland	6.0	3.8	5.3	5.7	7.3	7.9	8.0	6.3	I**
20	Belgium	9.1	7.5	7.8	7.9	8.0	8.2	7.9	8.1	D*
21	El Salvador	-	-	3.7	4.2	4.9	7.9	7.9	5.7	I***
22	Japan	7.3	6.9	7.5	7.6	8.1	8.1	7.9	7.6	I
23	Sweden	5.7	5.6	6.1	6.7	7.3	7.9	7.9	6.7	I**
24	Costa Rica	8.2	6.9	5.4	5.4	7.2	7.1	7.8	6.9	Mixed
25	Italy	6.8	5.4	5.6	5.9	7.2	7.2	7.8	6.4	I*
26	Norway	6.9	5.7	6.0	6.7	7.6	7.9	7.8	6.9	I
27	Portugal	5.8	3.3	5.6	5.6	6.4	7.9	7.8	6.1	I**
28	Bahrain	-	-	7.7	7.3	7.3	7.4	7.7	7.5	S
29	Oman	-	-	6.4	7.4	6.9	7.4	7.6	7.1	I*
30	Panama	-	7.6	6.7	7.0	6.9	8.2	7.6	7.3	S
31	Peru	4.3	3.3	3.3	2.3	3.8	7.2	7.6	4.5	I***
32	Philippines	5.3	4.7	5.0	5.0	5.6	7.2	7.6	5.8	I**
33	Spain	6.7	5.9	6.1	6.3	6.9	8.0	7.6	6.8	I
34	France	7.2	6.0	6.3	6.3	7.6	7.9	7.5	7.0	S
35	Nicaragua	-	7.5	3.7	1.7	3.0	5.6	7.5	4.8	Mixed
36	Estonia	-	-	-	-	-	5.9	7.4	6.6	I*
37	Mauritius	-	4.6	4.5	6.3	5.8	7.5	7.4	6.0	I**
38	Greece	6.3	5.8	5.7	5.2	6.1	7.2	7.3	6.2	I*
39	Paraguay	-	-	6.1	5.4	6.3	7.4	7.3	6.5	I*
40	Taiwan	7.0	6.0	6.8	7.1	7.4	7.4	7.3	7.0	S
41	Dominican Rep.	-	4.0	5.4	5.7	4.6	6.0	7.2	5.5	I***
42	Kuwait	-	-	4.7	6.9	5.5	6.7	7.2	6.2	I**
43	Hungary	-	-	4.5	4.8	4.7	6.9	7.1	5.6	I**
44	South Korea	6.3	5.7	5.8	5.8	6.3	7.0	7.1	6.3	I
45	Uganda	-	-	2.6	2.7	2.7	4.9	7.1	4.0	I***
46	Latvia	-	-	-	-	-	5.5	7.0	6.2	I*
47	South Africa	7.5	6.2	6.0	5.6	5.5	6.0	7.0	6.3	Mixed
48	Trinidad & Tob.	-	4.4	4.8	4.7	5.5	6.8	7.0	5.5	I**
49	Unit.Arab.Emir.	-	-	6.1	6.8	7.7	-	7.0	6.9	I
50	Botswana	-	3.8	5.0	5.6	5.7	6.1	6.9	5.5	I***
51	Namibia	-	-	-	-	4.6	6.1	6.9	5.9	I**
52	Egypt	-	4.0	4.0	4.5	4.3	5.3	6.8	4.8	I**
53	Jordan	-	5.2	5.4	6.0	4.9	5.8	6.8	6.0	I*
54	Thailand	6.4	5.6	5.8	6.0	6.6	7.3	6.8	6.4	I
55	Uruguay	-	6.2	6.2	6.5	6.8	6.9	6.8	6.6	I
56	Guatemala	6.4	7.3	6.5	5.1	6.2	7.9	7.9	6.8	I*
57	Israel	4.5	4.1	3.6	4.3	4.6	5.9	6.7	4.8	I**
58	Malaysia	6.5	6.3	7.0	7.0	7.5	7.4	6.7	6.9	S
59	Malta	6.1	5.4	5.1	5.0	5.1	6.7	6.7	5.7	I
60	Czech Republic	-	-	-	-	3.8	6.7	6.6	5.7	I**
61	Honduras	-	8.1	5.4	5.4	6.1	7.2	6.2	6.4	Mixed
62	Lithuania	-	-	-	-	-	5.5	6.5	6.0	I*
63	Mexico	6.9	5.6	5.1	4.9	6.5	7.0	6.5	6.1	Mixed
64	Bahamas	-	6.3	5.9	6.1	5.9	5.8	6.4	6.1	S

65	Cyprus	-	6.2	5.7	5.7	5.9	6.3	6.4	6.0	S
66	Ecuador	3.8	5.6	5.9	4.6	5.5	6.7	6.4	5.5	I**
67	Guyana	-	-	4.2	3.8	-	5.2	6.4	4.9	I**
68	Belize	-	-	5.5	4.9	5.2	6.2	6.3	5.6	I
69	Kenya	5.1	4.8	4.6	5.1	5.0	5.7	6.3	4.7	I*
70	Slovak Republic	-	-	-	-	3.8	6.3	6.3	5.5	I**
71	Zambia	-	4.2	4.7	3.3	2.9	4.9	6.3	4.4	I**
72	Fiji	-	5.0	5.2	5.3	5.6	6.0	6.2	5.5	I*
73	Indonesia	4.9	5.0	5.2	6.2	6.7	6.8	6.2	5.9	I*
74	Morocco	5.5	4.9	3.9	4.9	4.7	6.2	6.2	5.2	I
75	Slovenia	-	-	-	-	-	5.9	6.2	6.0	S
76	Turkey	3.1	3.3	3.6	5.0	5.4	6.2	6.2	4.7	I***
77	Venezuela	7.6	6.6	7.0	6.1	5.7	4.2	6.1	6.2	Mixed
78	Tunisia	4.3	4.5	4.5	4.2	4.7	5.4	6.0	4.8	I*
79	Bulgaria	-	-	-	6.0	3.9	5.1	5.9	5.2	S
80	Jamaica	-	4.9	3.9	4.8	5.6	7.0	5.9	5.3	Mixed
81	China	-	-	3.2	4.3	3.7	5.1	5.8	4.4	I**
82	Colombia	4.9	4.6	4.5	5.0	5.0	5.3	5.8	5.0	I
83	Sri Lanka	-	-	4.3	4.6	4.3	6.2	5.8	5.0	I*
84	Tanzania	4.3	3.2	4.2	3.2	3.6	4.9	5.8	4.2	I*
85	Barbados	-	5.4	5.6	6.1	6.0	6.0	5.7	5.8	S
86	Poland	-	-	-	3.6	4.6	6.3	5.7	5.0	I**
87	Ghana	3.3	2.6	1.9	2.4	4.7	6.0	5.6	3.8	I**
88	Cote d'Ivoire	-	-	4.8	5.3	4.7	5.5	5.5	5.2	I
89	Haiti	-	-	5.2	5.5	4.7	5.6	5.4	5.3	S
90	Nepal	-	-	5.3	5.1	4.8	5.0	5.4	5.1	S
91	Zimbabwe	-	-	4.3	4.1	4.6	5.4	5.4	4.8	I*
92	Benin	-	5.1	5.3	5.0	5.7	4.9	5.3	5.2	S
93	India	4.1	3.4	4.4	4.0	4.0	4.5	5.3	4.2	I*
94	Mali	-	4.7	5.4	5.2	4.9	5.4	5.3	5.2	I
95	Croatia	-	-	-	-	-	4.1	5.2	4.6	I*
96	Brasil	5.6	4.5	4.2	3.2	4.2	5.0	5.1	4.5	Mixed
97	Niger	-	5.4	5.1	5.3	4.7	4.0	5.0	4.9	Mixed
98	Pakistan	3.5	2.9	3.5	4.2	4.0	5.3	5.0	4.1	I*
99	Cameroon	-	-	5.1	5.4	5.4	5.3	4.9	5.2	S
100	Bangladesh	-	2.9	2.9	3.1	3.1	4.2	4.8	3.5	I*
101	Senegal	-	-	4.9	4.6	4.7	3.7	4.8	4.7	S
102	Albania	-	-	-	-	2.8	4.8	4.7	4.1	I*
103	Burundi	-	3.2	3.3	4.1	3.9	3.6	4.7	3.8	I*
104	Chad	-	-	-	5.2	5.2	5.3	4.7	5.1	D
105	Iran	6.3	6.2	3.4	3.4	4.2	4.3	4.7	4.6	D*
106	Ukraine	-	-	-	-	-	2.8	4.6	3.7	I*
107	Congo, Rep. of	-	-	5.0	4.4	4.4	5.2	4.5	4.7	D
108	Nigeria	3.8	3.7	3.1	3.5	3.3	3.4	4.5	3.6	I
109	Togo	-	-	4.1	5.7	4.6	5.1	4.5	4.8	S
110	Central Afr. Rep.	-	-	5.2	4.5	4.4	4.6	4.4	4.6	D
111	Madagascar	5.6	4.1	4.0	4.3	3.5	4.4	4.4	4.3	D*
112	Malawi	-	4.9	4.2	4.6	4.9	4.1	4.4	4.5	D
113	Rwanda	-	2.1	3.6	-	3.8	3.9	4.4	3.5	I**
114	Gabon	-	-	3.6	4.8	5.1	5.3	4.3	4.6	Mixed
115	Papua New Gui.	-	4.2	4.6	6.2	6.1	5.9	4.3	5.2	D
116	Syria	4.3	5.3	3.7	2.9	2.7	3.5	4.3	3.8	S

117	Russia	-	1.6	1.6	1.6	1.5	4.8	3.9	2.5	I**
118	Romania	-	-	-	3.6	4.2	4.2	3.8	4.0	S
119	Sierra Leone	-	4.0	4.2	3.4	3.6	3.8	3.5	3.7	D
120	Guinea-Bissau	-	-	-	3.3	3.4	3.8	3.3	3.4	S
121	Congo, Dem.R.	4.6	3.2	2.9	3.9	3.4	3.9	3.0	3.5	D
122	Algeria	-	-	4.4	4.0	2.8	3.4	2.6	3.4	D*
123	Myanmar	-	-	2.6	2.1	1.3	2.2	1.9	2.0	D
	World (average)	6.2	5.5	5.3	5.3	5.5	6.2	6.4	5.6	

Source: Economic freedom of the world 2001. Annual report, Vancouver: Fraser Institute, 2001 (www.fraserinstitute.ca/publications/books/efw_2001/)

Note: Table represents the summary ratings for chosen years. Column “Tendency” indicates the change in index over the period: Increase and decrease from 0.00 to 0.40 are indicated by S, increase from 0.40 to 0.99 by I, increase from 1.00 to 1.99 by I*, increase from 2.00 to 2.99 by I**, and increase larger than 3 by I***. Decrease from 0.40 to 0.99 is indicated by D, from 1.00 to 1.99 by D*.

Appendix 2: Economic freedom 1995-2002.

Rank 2002	Country	2002	2001	2000	1999	1998	1997	1996	1995	Tendency
1	Hong Kong	9.20	9.25	9.25	9.25	9.25	9.25	9.25	9.25	S
2	Singapore	8.70	8.60	8.90	9.00	9.00	8.75	8.75	8.75	S
3	New Zealand	8.25	8.25	8.25	8.25	7.90	7.90	7.90	7.90	S
4.	Estonia	8.00	7.40	7.00	6.60	6.75	6.30	6.30	6.50	I**
5	Ireland	8.00	8.40	7.75	7.75	7.75	7.25	7.25	7.25	I*
6.	Luxembourg	8.00	8.10	8.00	7.60	7.90	7.50	7.50	-	I
7	Netherlands	8.00	7.90	7.40	7.40	7.25	7.60	7.75	-	S
8	United States	8.00	8.10	8.00	8.00	7.90	8.00	7.90	7.75	S
9	Australia	7.90	7.75	7.75	7.75	7.75	7.10	7.40	7.40	I
10	Chile	7.90	7.50	7.50	7.25	7.10	7.00	6.10	6.00	I*
11	UK	7.90	8.00	7.75	8.00	7.90	7.75	7.75	7.75	S
12	Denmark	7.75	7.40	6.90	6.90	6.90	7.40	7.50	-	S
13	Switzerland	7.75	7.75	7.75	7.75	7.60	7.70	7.60	-	S
14	Finland	7.60	7.10	7.00	7.00	7.10	7.00	6.60	-	I*
15	Bahrain	7.50	7.75	8.00	8.00	7.75	8.25	8.00	8.25	D

16	Canada	7.50	7.40	7.50	7.50	7.00	7.00	7.25	7.40	S
17	The Bahamas	7.30	7.10	7.00	7.00	7.40	7.40	7.25	6.90	S
18	El Salvador	7.30	7.60	7.50	7.10	6.50	6.50	6.40	5.90	I*
19	Sweden	7.30	6.90	6.60	6.60	6.40	6.40	5.90	5.90	I*
20	Austria	7.25	7.40	7.40	7.25	7.25	7.25	7.25	7.25	S
21	Belgium	7.25	7.25	7.25	7.25	7.25	7.25	7.25	7.25	S
22	Germany	7.25	7.25	7.00	7.00	6.75	7.00	7.00	7.25	S
23	Cyprus	7.10	7.10	6.10	5.90	5.75	6.00	6.00	-	I*
24	Iceland	7.10	7.10	7.10	7.10	7.10	6.90	-	-	S
25	Unit. Arab Emirates	7.10	7.40	7.10	7.10	6.90	7.00	7.00	-	S
26	Barbados	6.75	6.50	6.30	6.00	6.30	5.75	5.25	-	I*
27	Portugal	6.75	6.75	6.75	6.75	6.50	6.50	5.90	5.75	I
28	Spain	6.75	6.50	6.50	6.50	6.40	6.10	5.75	6.30	I
29	Italy	6.60	6.75	6.75	6.75	6.50	6.30	6.00	6.30	S
30	Lithuania	6.60	6.10	5.25	5.00	5.00	4.75	3.90	-	I**
31	Taiwan	6.60	7.25	7.50	7.75	7.60	7.60	7.60	7.50	D
32	Czech Republic	6.50	7.00	7.00	7.00	6.60	7.00	7.00	7.00	D
33	Hungary	6.50	6.10	6.10	5.10	5.00	5.00	5.00	5.00	I*
34	Thailand	6.50	7.00	5.75	6.60	6.60	6.75	6.60	6.60	S
35	Japan	6.40	7.40	7.10	7.40	7.50	7.40	7.40	7.90	D*
36	Norway	6.40	6.40	6.75	6.60	6.60	6.40	6.40	-	S
37	Trinidad & Tobago	6.40	6.30	6.60	6.30	6.00	6.00	6.00	-	S
38	Argentina	6.25	6.90	7.25	7.25	6.75	6.00	6.10	5.60	Mixed
39	South Korea	6.25	6.90	6.50	7.00	6.90	6.90	6.75	7.10	D
40	Latvia	6.25	5.90	5.90	5.60	5.40	5.10	4.90	-	I*
41	Uruguay	6.10	6.60	6.10	5.90	5.90	5.90	5.40	5.25	I
42	Cambodia	6.00	5.40	5.00	5.00	4.75	3.70	-	-	I**
43	Costa Rica	5.90	5.90	5.40	5.10	5.10	5.10	5.10	5.25	I
44	Israel	5.90	5.60	5.60	5.60	5.60	5.60	5.00	5.25	I
45	Armenia	5.75	5.10	4.75	3.90	3.75	3.75	3.10	-	I**
46	Belize	5.75	5.75	5.50	5.40	5.10	5.60	5.60	5.75	S
47	Bolivia	5.75	6.50	5.90	5.60	6.00	5.75	5.75	4.75	I
48	France	5.75	6.30	6.30	6.50	6.50	6.50	6.75	6.75	D
49	Jordan	5.75	5.25	5.25	5.25	5.25	5.50	5.10	4.90	I
50	Malta	5.75	5.50	5.10	4.90	4.90	4.60	4.40	4.10	I*
51	Panama	5.75	6.10	6.50	6.50	6.50	6.30	6.30	6.50	D
52	Poland	5.75	5.60	5.50	5.50	5.25	4.75	4.75	4.25	I*
53	Kuwait	5.60	6.10	6.30	6.30	6.00	6.30	6.30	-	D
54	Peru	5.60	6.30	6.40	6.10	5.40	5.25	5.25	4.25	I*
55	Greece	5.50	5.75	5.60	5.40	5.40	5.50	5.25	5.00	S
56	Guatemala	5.50	5.75	5.75	5.90	5.75	5.75	5.40	4.90	I
57	Sri Lanka	5.50	5.75	5.25	5.60	5.60	6.30	5.50	5.00	I
58	Colombia	5.40	5.10	5.25	5.25	5.00	4.90	4.90	5.25	S
59	Tunisia	5.40	5.25	5.00	5.00	5.50	5.50	5.75	5.25	S
60	Botswana	5.25	5.10	5.10	5.10	5.10	4.90	5.00	4.25	I*
61	Ivory Coast	5.25	5.00	3.90	3.60	3.90	3.50	3.75	4.50	Mixed
62	Jamaica	5.25	5.50	6.30	5.75	5.75	5.75	5.50	5.25	S
63	Mali	5.25	5.10	5.25	5.00	4.75	4.50	4.40	4.25	I
64	Mexico	5.25	5.10	5.00	4.50	4.25	4.40	4.75	5.40	S
65	Mongolia	5.25	5.00	4.60	4.40	4.60	4.10	3.75	4.20	I*
66	Namibia	5.25	5.10	5.25	5.40	5.25	5.25	-	-	S
67	Oman	5.25	5.75	5.50	5.40	5.75	5.50	5.25	5.75	S

68	Slovak Republic	5.25	5.40	5.00	4.75	4.60	4.90	5.00	5.50	S
69	South Africa	5.25	4.90	5.25	5.25	5.50	5.25	5.00	5.00	S
70	The Philippines	5.10	4.90	5.40	5.40	5.90	5.40	5.10	4.50	Mixed
71	Qatar	5.10	4.60	4.90	4.60	-	-	-	-	S
72	Dom. Republic	5.00	5.40	5.25	4.75	4.50	4.75	4.50	4.00	I
73	Mauritius	5.00	5.10	5.40	5.90	-	-	-	-	D
74	Saudi Arabia	5.00	5.00	5.10	5.40	5.75	5.50	5.50	-	S
75	Uganda	5.00	5.00	5.00	6.30	6.30	6.00	5.70	3.50	I*
76	Centr. Afr. Republic	4.80								
77	Morocco	4.80	5.75	5.60	5.40	4.90	5.25	5.45	5.10	S
78	Mozambique	4.80	4.10	3.00	2.75	2.25	2.50	2.25	2.00	I**
79	Algeria	4.75	4.50	3.90	3.75	3.90	3.75	3.75	3.75	I
80	Brazil	4.75	4.40	3.75	4.25	3.90	3.90	3.60	4.25	I
81	Djibouti	4.75	4.10	4.00	4.25	3.90	4.40	-	-	S
82	Gambia	4.75	4.10	4.00	4.25	3.75	4.00	-	-	I
83	Madagascar	4.75	4.75	4.50	4.40	4.10	4.40	4.10	3.90	I
84	Malaysia	4.75	5.00	5.75	6.00	6.00	5.50	5.75	6.50	D*
85	Paraguay	4.75	4.50	5.50	5.50	5.50	5.90	5.90	5.90	D*
86	Slovenia	4.75	5.25	5.00	5.25	5.00	4.25	3.75	-	Mixed
87	Swaziland	4.75	5.00	5.00	5.25	5.25	4.75	4.50	5.00	S
88	Benin	4.60	5.25	5.25	5.00	4.75	4.75	4.50	-	S
89	Cape Verde	4.60	4.10	3.25	3.00	3.50	3.50	4.00	-	I
90	Honduras	4.60	4.10	4.10	3.90	4.40	4.10	4.25	4.40	S
91	Lebanon	4.60	5.40	4.50	4.40	4.40	5.10	4.90	-	S
92	Nicaragua	4.60	3.90	3.50	3.50	3.75	3.25	3.50	2.50	I**
93	Burkina Faso	4.50	4.25	4.00	3.75	3.50	3.50	3.00	-	I*
94	Guyana	4.50	4.10	4.50	4.50	4.00	4.25	4.25	3.50	I
95	Kenya	4.50	4.60	4.90	4.90	4.75	4.40	4.10	4.25	S
96	Senegal	4.50	4.90	4.90	4.60	4.25	3.90	3.25	-	I
97	Cameroon	4.35	4.50	4.00	4.00	3.00	3.25	3.00	4.25	S
98	Gabon	4.35	4.40	4.75	5.00	5.00	4.50	4.00	5.00	D
99	Macedonia	4.35	-	-	-	-	-	-	-	-
100	Zambia	4.35	4.60	5.25	5.25	5.25	5.60	5.00	4.75	S
101	Albania	4.25	3.75	3.25	3.50	3.25	3.50	3.25	3.50	I
102	Guinea	4.25	4.75	4.75	4.75	5.25	4.50	5.00	4.60	S
103	Mauritania	4.25	3.25	3.00	3.25	3.10	2.75	2.75	3.10	I
104	Pakistan	4.25	3.90	4.00	3.90	4.50	4.50	4.60	4.60	S
105	Indonesia	4.10	3.60	3.75	4.75	5.40	5.25	2.85	4.00	S
106	Moldova	4.10	3.50	4.50	4.25	4.00	4.00	4.00	2.75	I
107	Turkey	4.10	5.25	5.60	5.50	6.00	5.75	5.25	5.50	D
108	Bulgaria	4.00	4.25	4.00	3.75	3.40	3.50	3.75	3.75	S
109	Croatia	4.00	3.90	3.75	3.50	3.40	3.50	3.50	-	I
110	Fiji	4.00	4.00	4.25	4.25	4.50	4.25	4.60	4.00	S
111	Georgia	4.00	3.60	3.40	3.40	3.40	2.90	2.60	-	I*
112	Ghana	4.00	4.75	4.75	4.75	4.50	4.50	4.50	4.25	S
113	Lesotho	4.00	4.00	3.60	3.90	3.75	3.40	3.40	-	I
114	Nepal	4.00	3.75	3.50	4.25	4.00	3.40	3.60	-	S
115	Rwanda	4.00	3.50	2.50	2.50	2.00	1.75	-	-	I*
116	Tanzania	4.00	3.75	4.00	4.50	4.50	4.40	3.75	3.50	S
117	Ecuador	3.90	3.90	4.75	5.00	5.25	4.75	4.75	4.50	D
118	Azerbaijan	3.75	2.60	2.00	2.00	1.75	0.65	0.60	-	I**
119	Malawi	3.75	3.60	3.40	3.40	3.25	3.40	3.50	3.75	S

120	Niger	3.75	3.75	3.00	3.50	3.00	2.75	2.50	-	I*
121	China	3.60	3.50	4.00	3.50	3.75	3.50	3.50	3.50	S
122	Egypt	3.60	3.50	3.75	4.00	4.10	3.60	3.90	3.25	S
123	Ethiopia	3.60	3.40	3.75	3.75	3.75	3.50	3.60	3.10	S
124	India	3.60	2.90	3.00	3.00	3.00	3.00	2.90	3.00	I
125	Chad	3.50	3.50	3.80	2.75	2.50	2.50	-	-	I
126	Kazakhstan	3.50	3.10	3.25	2.60	2.50	-	-	-	I
127	Kyrgyz Republic	3.50	3.40	3.50	3.50	3.00	-	-	-	S
128	Nigeria	3.50	4.10	4.25	4.50	4.50	4.25	4.00	4.40	D
129	Togo	3.50	3.10	3.00	2.75	-	-	-	-	I
130	Venezuela	3.40	3.60	4.25	4.25	4.00	4.00	3.75	5.00	D*
131	Bangladesh	3.25	3.00	3.10	3.10	3.75	3.75	3.75	3.50	S
132	Romania	3.25	3.40	4.25	4.25	4.25	4.00	3.40	3.50	S
133	Russia	3.25	3.25	3.25	3.75	4.10	3.60	3.75	4.00	D
134	Congo, Rep. of	3.10	3.25	2.75	2.60	1.10	2.50	2.25	-	I
135	Yemen	3.10	2.90	2.90	2.40	2.25	2.50	2.90	3.00	S
136	Haiti	3.00	2.75	2.50	2.50	2.25	2.25	1.50	1.50	I*
137	Tajikistan	2.90	2.60	2.50	2.50	1.90	-	-	-	I
138	Ukraine	2.90	2.90	3.50	3.50	3.00	3.10	3.00	3.25	S
139	Vietnam	2.90	2.25	1.75	1.75	1.60	1.40	1.40	1.25	I*
140	Bosnia & Herzegov	2.75	2.50	1.50	0.75	0.75	-	-	-	I**
141	Equatorial Guinea	2.75	2.75	2.40	2.60	-	-	-	-	S
142	Guinea-Bissau	2.60	2.50	1.75	2.00	-	-	-	-	I
143	Suriname	2.60	2.90	2.75	2.75	2.75	2.75	2.50	-	S
144	Yugoslavia, FR	2.40	-	-	-	-	-	-	-	-
145	Burma (Myanmar)	2.25	2.00	2.25	2.25	2.00	1.75	1.75	-	I
146	Syria	2.25	2.50	2.50	2.25	2.60	2.60	2.50	-	S
147	Zimbabwe	1.75	1.90	2.75	2.75	2.50	3.10	3.10	3.00	D
148	Belarus	1.60	1.90	2.25	2.25	2.50	3.00	4.00	3.25	D
149	Uzbekistan	1.60	1.40	1.50	1.50	1.25	-	-	-	S
150	Turkmenistan	1.50	1.50	1.75	1.75	2.00	-	-	-	D
151	Iran	1.10	0.75	1.10	1.10	0.70	0.70	0.90	-	S
152	Laos	1.10	0.90	1.00	1.00	1.25	1.40	1.60	-	D
153	Cuba	0.60	0.60	0.60	0.40	0.40	0.40	0.40	0.40	S
154	Lybia	0.60	0.25	0.40	0.40	0.25	0.25	0.40	-	S
155	Iraq	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	S
156	North Korea	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	S
-	Angola	-	-	1.25	1.25	1.50	1.50	1.50	1.75	D
-	Burundi	-	-	2.50	2.00	2.00	2.25	-	-	S
-	Congo, Dem. Rep.	-	-	0.75	0.75	2.60	2.10	2.00	2.75	D**
-	Sierra Leone	-	-	3.00	3.25	3.50	3.60	3.75	3.50	S
-	Somalia	-	-	0.50	0.50	0.75	0.75	0.75	-	S
-	Sudan	-	-	2.90	2.40	2.00	2.00	2.25	2.25	I

Source: **The 2002 Index of economic freedom**, <http://cf.heritage.org/index/indexoffreedom.cfm>, **The 2001 Index of economic freedom**, Washington: Heritage foundation, <http://database.townhall.com/heritage/index/indexoffreedom.cfm>, and: **The 2000 Index of economic freedom**, Washington: Heritage foundation, 2000, pp. 22-26.

Note: The Heritage foundation scale is adjusted to be compatible to the Fraser Institute's scale. "Tendency" indicates the change of index over the period: Increase of 0 to 0.40 is indicated by **S**, 0.40 to 0.99 by **I**, 1.00 to 1.99 by **I***, and larger than 2 by **I****. Decrease of 0 to 0.40 is indicated by **S**, 0.40 to 0.99 by **D**, 1.00 to 1.99 by **D***, and more than 2 by **D****. "Mixed" represents larger changes in both directions.

For countries not ranked in 2002, it is taken the score for 2001 or 2000.

Appendix 3:

GDP average growth rates 1970-1999.

Country	1970-79	1980-89	1990-99	1970-99	No. of years
USA	3.3	2.7	3.0	3.0	30
Canada	4.7	2.9	2.2	3.3	30
Australia	4.5	3.3	3.7	3.8	30
Japan	5.2	3.8	1.8	3.6	29
N. Zealand	2.6	1.8	2.0	2.1	29
Austria	4.2	2.0	2.2	2.8	30
Belgium	-	1.7	2.0	1.8	14
Finland	3.7	3.7	1.7	3.0	30
France	3.8	2.3	1.7	2.6	30
Germany	3.1	1.8	3.0	2.6	30
Ireland	4.6	3.4	6.5	4.8	29
Italy	3.8	2.4	1.4	2.5	30
Luxembourg	3.0	4.7	2.7	3.5	23
Netherlands	2.7	3.0	3.4	3.0	30
Portugal	5.3	3.0	2.6	3.6	29
Spain	4.5	2.7	2.4	3.5	29
Denmark	2.2	1.8	2.3	2.1	28

Greece	5.4	1.8	1.9	3.0	30
Iceland	6.7	3.2	2.3	4.1	30
Norway	4.5	2.7	3.3	3.5	30
Sweden	2.5	2.7	1.4	2.2	29
Switzerland	1.7	2.2	0.9	1.6	30
UK	2.3	2.4	1.7	2.1	30
Industr. co.	3.6	2.7	2.4	2.9	29
Benin	3.1	1.6	4.5	3.2	29
Botswana	15.8	11.4	5.3	10.8	30
Burkina Fa.	-	3.4	4.0	3.7	20
Burundi	2.8	3.4	-1.1	1.7	28
Cameroon	5.1	5.0	-0.7	3.1	28
Chad	1.3	4.0	-	2.6	17
Congo, DR	0.3	1.6	-6.1	-1.4	28
Congo, Rep.	2.5	6.4	0.3	3.1	26
Cote d'Ivo.	-	1.6	3.4	2.5	11
Ethiopia	2.4	1.4	-0.5	1.1	22
Gambia	9.4	2.9	2.2	4.8	25
Ghana	2.0	1.8	4.5	2.8	27
Guinea-Bis.	-	3.4	4.1	3.7	11
Kenya	19.0	4.4	2.2	8.5	29
Liberia	1.7	-0.9	-	0.3	18
Madagascar	1.4	0.3	1.6	1.1	30
Malawi	5.8	1.7	3.9	3.8	25
Mauritius	5.3	4.7	5.3	5.1	30
Morocco	5.6	3.8	2.6	4.0	30
Mozambique	-	0.5	4.9	2.7	14
Namibia	-	0.1	4.8	2.4	10
Niger	-	0.6	2.3	1.4	14
Nigeria	7.0	1.5	3.8	4.1	28
Rwanda	4.8	1.8	2.5	3.0	30
Senegal	3.0	2.4	3.1	2.8	29
Sierra Leone	2.6	0.6	-4.9	-0.6	27
South Africa	3.2	2.2	1.3	2.2	29
Swaziland	12.2	4.9	3.7	6.9	20
Togo	3.3	1.3	1.7	2.1	28
Tunisia	7.4	3.4	5.0	5.3	30
Uganda	-	2.6	7.1	4.8	13
Zambia	2.1	1.4	1.2	1.6	27
Zimbabwe	1.5	4.8	2.7	3.0	25
Africa	4.7	2.5	2.5	3.2	29
Bangladesh	6.7	4.0	4.9	5.2	26
China	-	9.5	9.7	9.6	21
Hong Kong	9.3	7.3	3.8	6.8	30
India	2.9	6.0	5.5	4.8	29
Indonesia	7.8	5.3	4.2	5.8	30
Korea, South	8.6	7.8	6.2	7.5	30
Laos	-	5.9	6.3	6.1	18
Malaysia	8.4	5.8	7.2	7.1	29
Mongolia	-	6.2	-0.6	2.8	18

Myanmar	5.5	1.8	5.5	4.3	23
Nepal	2.6	3.5	4.2	3.4	30
Pakistan	3.8	6.4	4.2	4.8	30
Papua, N.G.	1.5	1.6	8.4	3.8	20
Philippines	5.8	1.9	2.9	3.9	30
Singapore	9.5	7.3	7.6	8.1	30
Sri Lanka	4.0	4.2	5.3	4.5	29
Thailand	7.6	7.3	5.2	6.7	30
Asia	5.4	7.0	7.0	6.5	3.0
Egypt	-	6.0	4.3	5.1	16
Iran	5.9	0.4	5.3	3.9	29
Iraq	9.8	-0.2	-	-	19
Israel	12.0	3.2	4.7	6.6	27
Jordan	-	3.1	4.7	3.9	13
Kuwait	1.7	-1.9	2.1	0.6	26
Lybia	7.8	-2.3	-	2.7	11
Oman	11.2	8.3	5.5	8.3	29
Saudi Arabia	11.9	1.4	2.8	5.4	30
Syria	8.6	2.6	6.9	6.0	29
UAE	12.6	-1.1	7.0	6.2	19
Yemen, Rep.	-	-	3.0	-	9
Middle East	7.7	2.2	4.5	4.8	28
Armenia	-	-	5.8	-	4
Belarus	-	-	-0.6	-	7
Bulgaria	-	3.6	-4.8	-0.4	8
Croatia	-	-	-3.8	-	7
Kazakhstan	-	-	3.0	-	4
Cyprus	4.1	6.0	4.4	4.8	30
Czech Rep.	-	-	1.6	-	6
Estonia	-	-	4.2	-	5
Hungary	5.0	1.5	2.4	3.0	25
Kyrgyz Rep.	-	-	-5.1	-	6
Latvia	-	-	0.1	-	7
Lithuania	-	-	-1.4	-	7
Malta	11.1	4.0	5.1	6.7	30
Poland	-	1.3	1.7	1.5	18
Romania	-	1.7	-2.4	-0.3	18
Slovak Rep.	-	-	4.3	-	6
Slovenia	-	-	0.7	-	7
Turkey	4.7	4.2	4.6	4.5	29
Yugoslavia	6.1	0.7	-	3.4	19
Europe	-	2.7	1.4	2.0	18
Argentina	2.7	-1.0	5.1	2.3	29
Bolivia	5.2	-0.2	4.1	3.0	30
Brazil	8.0	2.8	2.4	4.4	29
Chile	1.8	3.5	6.4	3.9	30
Colombia	5.8	3.4	4.1	4.4	28
Costa Rica	6.3	2.5	4.5	4.4	30
Domin. Rep.	7.3	3.6	4.7	5.2	30

Ecuador	9.2	2.3	2.9	4.8	29
El Salvador	4.5	-1.2	4.6	2.6	30
Guatemala	5.9	0.9	4.0	3.6	30
Haiti	4.1	0.2	-0.5	1.3	30
Honduras	5.2	2.5	2.8	3.5	30
Jamaica	0.6	2.2	0.7	1.2	29
Mexico	6.5	2.3	3.4	4.1	30
Nicaragua	-0.3	-0.9	2.8	0.5	30
Panama	6.3	1.8	4.9	4.3	30
Paraguay	8.1	3.7	2.3	4.7	29
Peru	4.0	0.3	3.8	2.7	30
Trin.& Tob.	4.6	-2.9	2.2	1.3	29
Uruguay	2.9	1.0	3.2	2.4	30
Venezuela	5.2	0.1	2.4	2.6	30
West.Hemis.	5.9	2.2	3.3	3.8	29
World	4.0	3.4	3.6	3.7	30

Source: **International financial statistics yearbook**, Washington: IMF, 2000, pp. 164-7, own calculation.

Appendix 4:

GDP growth rates of transition countries (average annual change in %)

Country/Year	1980-1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	1992-2001
Albania	2,5	-	-	-7,2	9,6	9,4	8,9	9,1	-7,0	7,9	7,2	7,8	8,0	5,4
Azerbaijan	-	-	-0,7	-22,6	-23,1	-19,7	-11,8	1,3	5,8	10,0	7,4	11,1	-	-4,6
Belarus	-	-	-1,2	-9,7	-7,0	-12,6	-10,4	2,8	10,4	8,3	3,4	5,9	3,0	-0,6
Bosnia & H.	-	-	-	-	-	-	32,4	85,8	39,9	10,0	10,0	4,6	4,0	26,7
Bulgaria	3,6	-9,1	-11,7	-7,3	-1,5	1,8	2,1	-10,9	-6,9	3,5	2,4	5,8	4,5	-0,6
Czech rep.	-	-	-	-	0,1	2,2	5,9	4,3	-0,8	-1,2	-0,4	2,9	3,3	1,8
CSSR, ex	2,5	-0,4	-15,9	-8,5	-	-	-	-	-	-	-	-	-	-
Estonia	-	-	-7,9	-21,6	-8,2	-1,8	4,6	4,0	10,4	5,0	-0,7	6,9	4,5	0,3
Georgia	-	-	-20,6	-44,8	-29,3	-10,4	2,6	10,5	10,7	2,9	3,0	1,8	-	-5,9
Croatia	-	-	-	-	-8,0	5,8	6,8	6,0	6,5	2,5	0,4	3,7	3,5	2,9
Armenia	-	-	-12,4	-52,6	-14,1	5,4	6,9	5,9	3,3	7,3	3,3	6,0	-	-3,2
Kazakhstan	-	-	-11,0	-5,3	-9,2	-12,6	-8,3	0,5	1,6	-1,9	2,8	9,5	9,0	-1,4
Kyrgyz rep.	-	-	-7,9	-13,9	-15,5	-19,8	-5,8	7,1	10,0	2,1	3,7	5,0	-	-3,0
Latvia	-	-	-11,1	-35,2	-14,9	0,6	-0,8	3,3	8,6	3,9	1,1	6,6	7,0	-2,0
Lithuania	-	-	-5,7	-21,3	-16,2	-9,8	3,3	4,7	7,3	5,1	-3,9	3,9	3,9	-2,3
Hungary	1,5	-3,5	-11,9	-3,1	-0,6	2,9	1,5	1,3	4,6	4,9	4,5	5,2	3,7	2,5
Macedonia	-	-	-	-	-7,5	-1,8	-1,1	1,2	1,4	2,9	2,7	5,0	5,0	0,9
Moldova	-	-	-17,5	-29,7	-1,1	-31,1	-1,4	-5,9	1,6	-6,5	-3,4	1,9	4,0	-7,1
Mongolia	6,6	-5,6	-9,2	-9,5	-2,9	2,3	6,3	2,4	4,0	3,5	3,2	1,1	-	1,1
Poland	-	-7,2	-7,0	2,6	4,3	5,2	6,8	6,0	6,8	4,8	4,1	4,1	1,5	4,6
Romania	1,7	-7,7	-12,9	-8,8	1,5	3,9	7,3	3,9	-6,1	-4,8	-2,3	1,6	4,8	0,1
Russia	-	-	-5,4	-19,4	-13,0	-13,5	-4,2	-3,4	0,9	-4,9	5,4	8,3	5,8	-3,8

SFRJ, ex	0,7	-7,5	-17,0	-34,0	-	-	-	-	-	-	-	-	-	-	-
Slovak rep.	-	-	-	-	-3,7	4,9	6,7	6,2	6,2	4,1	1,9	2,2	2,7	3,5	
Slovenia	-	-	-	-	2,8	5,3	4,1	3,5	4,6	3,8	5,2	4,9	3,0	4,1	
Tajikistan	-	-	-7,1	-28,9	-11,1	-21,4	-12,5	-4,4	1,7	5,3	3,7	8,3	-	-6,6	
Turkmenistan	-	-	-4,7	-5,3	-10,0	-17,3	-7,2	-6,7	-11,3	5,0	16,0	17,6	-	-2,1	
Ukraine	-	-	-10,6	-17,0	-14,2	-22,9	-12,2	-9,8	-3,3	-1,9	-0,2	5,8	8,2	-6,7	
Uzbekistan	-	-	-0,5	-11,1	-2,3	-4,2	-0,9	1,6	2,5	4,3	4,4	4,0	-	-0,2	

Source: **The World Bank files** (Internet) and **World Economic Outlook**, December 2001.
Estimates for 2001. Own calculation.

Ranking of transition countries according to the growth rates 1992-2001.

1. Albania	5.4	14. Belarus	-0.6
2. Poland	4.6	15. Kazakhstan	-1.4
3. Slovenia	4.1	16. Latria	-2.0
4. Slovak R	3.5	17. Turkmenistan	-2.1
5. Croatia	2.9	18. Lithuania	-2.3
6. Hungary	2.5	19. Kygyz Rep.	-3.0
7. Czech R.	1.8	20. Armenia	-3.2
8. Mongolia	1.1	21. Russia	-3.8
9. Macedonia	0.9	22. Azerbaijan	-4.6
10. Estonia	0.3	23. Georgia	-5.9
11. Romania	0.1	24. Tajikistan	-6.6
12. Uzbekist.	-0.2	25. Ukraine	-6.7
13. Bulgaria	-0.6	26. Moldova	-7.1

* Bosnia is omitted from the ranking.